ARCHIVE

APPENDIX—TABLE OF CONTENTS

		Page
A.	OPINION OF THE COURT OF APPEALS	1a
B.	OPINION AND ORDER OF THE DISTRICT COURT	12a
C.	OPINION AND ORDER OF THE COURT OF APPEALS ON REHEARING	24a
D.	THE RURAL ELECTRIFICATION ADMINISTRATION'S DECISION	35a
E.	EXCERPTS FROM THE RURAL ELECTRIFICATION ACT	76a
F.	THE SUPREMACY CLAUSE OF THE UNITED STATES CONSTITUTION	82a

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 93-4295

CITY OF MORGAN CITY,
Plaintiff-Intervenor-Defendant-Appellant,

v.

SOUTH LOUISIANA ELECTRIC COOPERATIVE ASSOCIATION,
Defendant-Intervenor-Appellee,
Third Party-Plaintiff-Appellee,

and

CAJUN ELECTRIC POWER COOPERATIVE, INC.,
Intervenor-Plaintiff-Appellee,

and

UNITED STATES OF AMERICA, thru Rural Electrification Administration (REA),
Third Party-Defendant-Appellee.

Appeal from the United States District Court
for the Western District of Louisiana

Sept. 12, 1994

Before POLITZ, Chief Judge, DAVIS and WIENER, Circuit Judges.

W. EUGENE DAVIS, Circuit Judge:

This appeal revolves around a municipality's attempt to condemn equipment and electricity consumers within an area annexed by the municipality. South Louisiana Electric Cooperative Association (SLECA), the current electricity providers, along with their federal financier, the Rural Electrification Administration (REA), opposed the state-law expropriation and sought summary judgment. The district court found that the REA Administrator had authority under the Rural Electrification Act (REAct), 7 U.S.C. § 901 et seq., to withhold approval of the state-law expropriation so that the state-law expropriation was preempted under the Supremacy Clause, 837 F.Supp. 194. We affirm on the alternative ground that the state-law expropriation is preempted because it would frustrate a federal purpose.

I.

In January 1985, the City of Morgan City annexed a small suburban area containing approximately 252 electricity consumers. These electricity consumers were serviced by SLECA, a rural power cooperative financed by the federal government under the REAct.[1] SLECA buys its power in bulk from Cajun Electric Power Cooperative (Cajun), also an REA-financed cooperative.[2] To secure their federal loans, SLECA and Cajun have mortgaged their assets to the REA.

After the annexation, Morgan City, which operates its own municipal utility,[3] offered to purchase all of SLECA's

---

[1] To date, SLECA has obtained 25 REA loans totalling over $38 million, $25 million of which is outstanding.

[2] To date, Cajun has obtained $3 billion in REA loans.

[3] Morgan City's utility system purchases its bulk supply from the Louisiana Energy and Power Authority and sells to its customers at a rate 15% lower than SLECA's.

property in the area, including the exclusive right to provide power to electricity consumers in the area. When SLECA refused the offer, Morgan City brought this expropriation action pursuant to L.R.S. 19:101 et seq., seeking to condemn the disputed property rights.

Cajun intervened as a party defendant. The REA was joined as a third party defendant on the basis of its security interest in the property at issue and removed the case to federal court.

Thereafter, the REA Administrator filed into the record a signed declaration objecting to Morgan City's state-law expropriation on grounds that the expropriation would jeopardize the REA's ability to protect its loans and would cause substantial harm to the federal rural electrification program.

The Administrator asserted that the threatened expropriation would frustrate the federal rural electrification program for several reasons. First, the annexed area is the most heavily populated part of SLECA's service area and thus is the area SLECA is able to serve most economically and efficiently. Thus, the disputed area provides SLECA with its most profitable customers. According to the Administrator, loss of this area's customer load could jeopardize SLECA's financial health and result in a rate increase for SLECA's remaining customers. The Administrator contends that this danger is especially acute in light of the impact of future planned expropriations in the Morgan City area whose cumulative impact on SLECA's electric system would be devastating.

The Administrator further objected to the expropriation on grounds that the expropriation could negatively affect not only SLECA, but the entire chain of REA-financed member cooperatives. Cajun provides power under wholesale contracts to twelve other REA-financed distribution cooperatives, which in turn distribute to rural electricity customers. Reduction in the volume of Cajun's

distributions as a result of this and other state-law expropriations could increase the cost of Cajun's wholesale power. This increase in cost of electric power would be passed on to the entire rural area serviced by federally financed member distributor cooperatives.

The REA, joined by SLECA and Cajun, filed a motion to dismiss or, in the alternative, for summary judgment, arguing that Morgan City's expropriation action was preempted by the REAct. The district court granted the defendants' summary judgment motion and dismissed the expropriation. The court based its ruling on two conclusions: (1) the Administrator's determination that the expropriation would be contrary to the federal rural electrification program was not arbitrary and capricious; and (2) the REAct, 7 U.S.C. § 907, authorized the Administrator to withhold approval of the transfer even though the transfer was involuntary. The City of Morgan City appeals.

II.

The federal government, when acting within the confines of its constitutional authority, is empowered to preempt state law to the extent necessary to achieve a federal purpose. U.S. Const. art. VI, cl. 2. The Supreme Court has explained that preemption of state law may occur in several different ways. *Louisiana Public Service Commission v. FCC*, 476 U.S. 355, 368-69, 106 S.Ct. 1890, 1898, 90 L.Ed.2d 369 (1986). First, Congress may expressly preempt state law. *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Dev. Comm'n*, 461 U.S. 190, 203, 103 S.Ct. 1713, 1722, 75 L.Ed.2d 752 (1983). Second, Congress may legislate so comprehensively that it creates a "reasonable . . . inference that Congress left no room for the States to supplement it." *Id.* at 204, 103 S.Ct. at 1722. Under such circumstances, where Congress intends that federal law "occupy the field"—i.e., be exclusive in the area, state law within the field is preempted. Third, state law is displaced to

the extent that it conflicts with federal action. *Id.* This last breed of preemption, conflict preemption, may occur in two ways. First, a provision of state law may be incompatible with a federal statute such that compliance with both is a "physical impossibility." *Id.* Second, even if compliance with both is not impossible, state law is nonetheless preempted if its application would disturb, interfere with, or seriously compromise the purposes of the federal statutory scheme. *Id.* In other words, an application of state law that would frustrate the purpose of a federal statutory scheme is preempted. *See id.* at 220-21, 103 S.Ct. at 1731.

In this case, we elect to turn directly to the applicability of the second variety of conflict preemption to the facts presented by the summary judgment evidence. *See United States v. Early,* 27 F.3d 140, 142 (5th Cir.1994) (court can affirm on an alternative basis). Accordingly, we save for another day the issue of whether 7 U.S.C. § 907 by its terms confers authority on the Administrator to withhold approval of an involuntary disposition, and instead consider only whether a conflict exists because the proposed state-law expropriation would frustrate a federal purpose.

Under the second variety of conflict preemption, Morgan City's expropriation may be preempted if the action would frustrate a federal purpose. Stated differently, state action is preempted if its effect is to discourage conduct that federal legislation specifically seeks to encourage. For example, in *Xerox Corp. v. County of Harris,* 459 U.S. 145, 103 S.Ct. 523, 74 L.Ed.2d 323 (1982), the Supreme Court held that a state tax could not be imposed on goods manufactured in Mexico, shipped to the United States, and held under bond in a customs warehouse awaiting shipment abroad. *Id.* at 154, 103 S.Ct. at 528. The Court found that a long history of federal legislation indicated a clear intent to create duty-free enclaves for such imported goods stored in this country pending ex-

port so as to encourage merchants to use American ports. *Id.* at 150-52, 103 S.Ct. at 525-27. The Court held that although a state tax on such goods was not expressly prohibited, its imposition was preempted because such a tax would manifestly discourage and financially penalize the very acts the federal law was meant to foster. In this vein, we therefore turn our attention in this case to the effect of the state-law expropriation on the federal legislation.

1. *The Goals of the REAct*

In 1936, Congress enacted the REAct for the purpose of ensuring that electric service would be provided to rural America. By enacting the legislation and creating the REA, Congress determined that the national interest would be served by subsidizing the rural user of electricity. Prior to the REAct, rural areas which were thinly populated and had lower demand for electricity failed to attract investor-owned utilities for the obvious reason that providing service to these areas was costly and therefore unprofitable. *See, e.g., Tri-State Generation & Transmission Assn., Inc. v. Shoshone River Power, Inc.*, 874 F.2d 1346, 1348 (10th Cir.1989). The REA encouraged rural electrification by providing low interest insured loans and loan guarantees to cooperatives. 7 U.S.C. § 903; *see also Alabama Power Co. v. Alabama Electric Cooperative, Inc.*, 394 F.2d 672 (5th Cir.1968).

In response to the REAct, rural communities formed non-profit electric distribution cooperatives, such as SLECA, which were financed by the REA. After these REA-financed distribution cooperatives were formed, groups of cooperatives banded together to form central generation and transmission cooperatives (G & Ts) to obtain a less expensive, long-term source of power. To enable the formation of the G & Ts, the member distribution cooperatives entered into long-term wholesale power contracts with the G & Ts for electricity. *See, e.g., Tri-State*, 874 F.2d at 1348.

The REA's security for loans is limited to the physical assets of its borrowers and the revenue generated by its borrowers, the G & T's and the distribution cooperatives. Thus, the relationship among the G & Ts, distribution cooperatives and the REA is structured through these wholesale power contracts. This contract obligates a distribution cooperative, such as SLECA, to purchase all of its electric power over a fixed term from a G & T, such as Cajun. When lending money to a G & T, the REA requires the G & T to enter into wholesale power contracts with member distribution cooperatives. Likewise, when the REA lends money to distribution cooperatives, the REA requires those distribution cooperatives to enter into similar contracts with G & Ts. This arrangement ensures that REA G & T and distribution borrowers will be able to earn revenue sufficient to meet their costs, service their REA debt, and continue to provide permanent, low-cost electric service to rural areas. *Id.*

2. *Louisiana's Expropriation Statute*

Morgan City seeks to condemn property, and, more significantly, the right to service electricity consumers who are currently serviced by SLECA and Cajun under a wholesale power contract. Louisiana's expropriation law provides generally that any Louisiana municipality may expropriate property whenever necessary for the public interest as determined by the governing authority of the municipality, or, in cases such as this, by the trial judge when the taking is contested. LSA-R.S. 19:102.

In this case, the critical question is whether Louisiana's expropriation law, as applied and interpreted, would frustrate the federal purpose underlying the REAct. We recognize that the Supreme Court has made clear that there is no litmus test for determining whether a particular application of state law would frustrate a federal purpose:

> This Court, in considering the validity of state laws in the light of . . . federal laws touching the same subject, has made use of the following expressions: conflicting; contrary to; occupying the field; repugnance; difference; irreconcilability; inconsistency; violation; curtailment; and interference. But none of these expressions provides an infallible constitutional test or an exclusive constitutional yardstick. In the final analysis, there can be no one crystal clear distinctly marked formula. Our primary function is to determine whether, under the circumstances of th[e] particular case, [state] law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.

Hines v. Davidowitz, 312 U.S. 52, 67, 61 S.Ct. 399, 404, 85 L.Ed. 581 (1941).

We find the Ninth Circuit's opinion in *Pend Oreille* helpful and persuasive in answering the question before us. In *Pend Oreille*, the Ninth Circuit concluded that under the Supremacy Clause, a state municipal public utility could not condemn property owned by a federally subsidized utility because the condemnation would interfere with the federal purpose of the REAct. *Pend Oreille*, 417 F.2d 200, 201-02 (1969). The Ninth Circuit reasoned that the proposed condemnation of a portion of a federally subsidized rural electrification system, even if compensated for under state law, would impair Congress's objective of providing reliable, low-cost electricity to rural America. The court concluded that removal of the targeted portion of the system would weaken the remainder of the system and lessen its ability to function effectively:

> This is not an ordinary case because what is sought to be taken here is part of a system and even if the part taken is paid for, and if an award is made for the damage to the remaining portion, a question remains as to the capacity of the remaining portions of the system to function. . . . [I]f, as a result of

> the condemnation, the loans were paid in full, but the remaining portions of the system could not continue to operate with decent service and at decent rates, the Government would have been paid but the purpose of the Rural Electrification Act would have been frustrated.

Id. at 201. The Ninth Circuit concluded that, under these circumstances, "a state [condemnation] law written so that a state-favored utility can by its unilateral action interfere with the federal purpose cannot stand under the Supremacy Clause." *Id.* at 202.

A panel of this court followed *Pend Oreille's* reasoning in an analogous case, *City of Madison v. Bear Creek Water Ass'n, Inc.*, 816 F.2d 1057 (5th Cir.1987). In *Bear Creek*, we barred a municipal utility's proposed condemnation of a densely populated portion of a federally subsidized rural water utility. In reaching this conclusion, the *Bear Creek* court reasoned that:

> Even if fair value is paid for the lost facilities, such an action would inevitably have an adverse effect on the remaining customers . . ., in the form of lost economies of scale and resulting higher per-user costs. To allow expanding municipalities to "skim the cream" by annexing and condemning those parts of a water association with the highest population density (and thus the lowest per-user cost) would undermine Congress's purpose of facilitating inexpensive water supplies for farmers and other rural residents and protecting those associations' ability to repay their FmHA debts.

Bear Creek, 816 F.2d at 1060 (citing *Big Bend*, 618 F.2d 601).

Morgan City argues that the relatively small number of SLECA consumers subject to this expropriation action distinguishes this case from both *Pend Oreille* and *Bear*

Creek. But 252 users in a densely populated area is significant, obviously enough to attract Morgan City's interest in providing electric service to the area. Here, as in *Bear Creek*, a municipally-owned utility seeks to condemn an economically profitable service area developed through federal financing. The state law authorizing the condemnation takes no account of the potential prejudice to rural electricity consumers served by federally funded cooperatives. Permitting Morgan City to condemn these 252 users would pave the way for piecemeal erosion of other high-density service areas adjacent to Morgan City and other cities. Such action could well leave federally funded cooperatives financially unable to continue service to the remaining low-density areas not targeted by municipally-owned or investor-owned utilities. And we do not consider this concern hypothetical in light of the evidence in the record of future proposed annexations in the Morgan City area, as well as the Houma, Louisiana area. *See Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 130-31, 98 S.Ct. 2207, 2216, 57 L.Ed.2d 91 (1978) (hypothetical conflict not sufficient to warrant preemption). The REA's conclusion that this attempted condemnation would jeopardize the federal rural electrification program is amply supported by the record.

Were Morgan City's expropriation action allowed to stand, it would "stand as an obstacle" to the repayment of federal loans, to the financial viability of federally financed electricity cooperatives, and ultimately, to the maintenance of electricity service to rural areas. *See Hines*, 312 U.S. at 67, 61 S.Ct. at 404. As the Ninth Circuit noted, "Congress has declared the federal purpose to electrify the American farm. No matter how we characterize the vehicle which gets the electricity there, a state law so written that a state favored utility can by its unilateral action interfere with the federal purpose cannot stand under the Supremacy Clause of the Constitution of the United States." *Pend Oreille*, 417 F.2d at 202.

Because we find that the proposed state-law condemnation would frustrate the federal purpose of providing low-cost, reliable electric service to rural areas, the state-law condemnation proceeding is preempted under the Supremacy Clause. We therefore affirm the district court's dismissal of that action.

AFFIRMED.

APPENDIX B

UNITED STATES DISTRICT COURT
W.D. LOUISIANA
LAFAYETTE-OPELOUSAS DIVISION

Civ. A. No. 91-0523

CITY OF MORGAN CITY

v.

SOUTH LOUISIANA ELECTRIC, *et al.*

Feb. 25, 1993

MEMORANDUM RULING

DOHERTY, District Judge.

This matter comes before the Court on a number of motions filed on behalf of both plaintiff and defendants in this matter. In order to facilitate ruling on the issues, the Court asked all parties to further brief the narrow issue of the Rural Electrification Administration ("REA") "approval authority" as to a condemnation by the State of electrical facilities which are indebted to the REA.

Procedural History

On August 3, 1990 the City of Morgan City filed in the 16th Judicial District Court, Parish of St. Mary, a petition for expropriation seeking to condemn property and electric service rights owned by defendant, South Louisiana Electric Cooperative Association ("SLECA"),

a federally financed, non-profit cooperative. On January 11, 1991, a petition of intervention was filed on behalf of Cajun Electric Power Cooperative, Inc. ("Cajun"); the United States was also joined as a third party defendant on the basis that the United States holds a security interest in the property which is the subject of this proceeding. The United States timely removed the state court proceeding to this Court on March 11, 1991. Cajun then filed with this Court on June 5, 1991 an amended petition of intervention, alleging noncompliance with 7 U.S.C. § 907 with this Court on June 5, 1991.

On August 29, 1991 Morgan City filed a Motion to Dismiss Cajun's amended petition of intervention and said motion was denied by the Honorable Richard T. Haik, Sr. on October 17, 1991. On December 9, 1991 this case was transferred to the Honorable Rebecca F. Doherty.

Presently before this Court are Motions to Dismiss and in the alternative for Summary Judgment filed on behalf of the United States of America, SLECA and Cajun, seeking to dismiss plaintiff's claims arguing that state law based expropriation cannot proceed under the Supremacy Clause of the United States Constitution, and the Rural Electrification Association, as part of the United States Department of Agriculture, has withheld its statutory and preemptive authority to approve the property transfer under 7 U.S.C. § 907. Also pending before the Court is a Motion for Partial Summary Judgment filed on behalf of the City of Morgan City based on preemption claiming the REA administrator has not met the procedural requirements under the Administrative Procedure Act, 5 U.S.C. § 553, and the Federal Register Act, 44 U.S.C. § 1505 and 1510, which are pre-conditions to administrative preemption by regulation, or in the alternative that the REA administrator has not been delegated by Congress the authority to preempt state law solely for the purpose of relieving the economic pressures on rural electrical cooperatives.

Morgan City has also filed an appeal from Magistrate Judge Methvin's ruling of October 22, 1992 wherein the Magistrate Judge denied the City's Motion to Compel production of documents and answers to interrogatories propounded to the United States of America. Additionally, the United States has filed a Motion to Strike documents filed by the City of Morgan City in support of their appeal of the Magistrate's ruling.

This Court GRANTS the Motion to Dismiss filed on behalf of the United States of America, SLECA and Cajun and DENIES the Motion for Partial Summary Judgment filed on behalf of the City of Morgan City. Further, this Court upholds the Magistrate's ruling and therefore DENIES the appeal by the City of Morgan City which renders MOOT the motion by the United States of America to strike documents filed in connection with the City of Morgan City's appeal of the Magistrate's ruling for the following reasons to wit:

This case concerns the pending expropriation by the City of Morgan City of approximately 252 SLECA customers, as well as the lines, poles, transformers and other equipment serving these customers. This expropriation is a result of Phase II of Morgan City's annexation plans, which went into effect in 1986. The annexation itself has occurred and therefore will not be affected by the outcome of this case. A Phase III annexation which would involve an additional approximately 267 SLECA customers and the same lines, poles, transformers and related equipment will occur in the future according to the sworn deposition testimony of the Honorable Cedric S. LaFleur, Mayor of the City of Morgan City and its consulting engineer, Harold J. Beard. Morgan City has offered to pay SLECA a total of $895,955.78 over a period of 8 years at $111,994.47 a year, for the expropriation of SLECA's facilities in Phase II. (SLECA Exhibit 1)

On June 16, 1992 a 28 page report with numerous attachments and studies, produced by the staff of the REA, was adopted by the administrator pursuant to 7 U.S.C. § 907, withholding his approval of the proposed expropriation by the City of Morgan City.

The REA Act provides at 7 U.S.C. § 907:

> "No borrower of funds under § 4 of § 201 (7 U.S.C. § 904 or § 922) shall, without the approval of the Administrator, sell or dispose of its property, rights, or franchises, acquired under the provisions of this Act, until any loan obtained from the Rural Electrification Administration, including all interest and charges, shall have been repaid."

The central issue in this matter has been the ongoing dispute between the parties as to the authority of the REA Administrator under § 907 to withhold approval of the expropriation and thereby essentially preempt Morgan City's state granted power of expropriation. This Court, in a minute entry dated December 4, 1992, asked all parties to brief the narrow issue of whether or not the REA has the authority pursuant to 7 U.S.C. § 907 to prevent the expropriation of SLECA's property by the City of Morgan City.

The Court now must make a determination of whether 7 U.S.C. § 907 preempts, by conflict and pursuant to the Supremacy Clause, the state expropriation power granted by the State of Louisiana to the City of Morgan City.

The inquiry begins with analysis of 7 U.S.C. § 907. Does the prohibition that no borrower shall without the administration's approval "sell or dispose of its property . . ." extend to *involuntary* disposal, i.e., expropriation.

This Court notes that the issue of REA's authority to approve or disapprove an expropriation pursuant to § 907 has been previously addressed in the Ninth Circuit cases of *Public Utility District No. 1 of Pend Oreille County v. United States*, 417 F.2d 200, 201-202 (9th Cir.1969) and *Public Utility District No. 1 of Franklin*

County v. Big Bend Electric, 618 F.2d 601, 603 (9th Cir.1980). In both cases, the Ninth Circuit held that under § 907 a borrower's property may not be disposed of by any means, including involuntary condemnation or expropriation, without REA's approval. The Fifth Circuit has expressly approved the holding and rationale of *Big Bend, supra*, in the case of *City of Madison, Miss. v. Bear Creek Water Association, Inc.*, 816 F.2d 1057, 1060 (5th Cir. 1987).

It is apparent to this Court that the Fifth Circuit Court of Appeals has enforced the Supremacy Clause principles barring municipal condemnations that interfere with federal programs. In *Bear Creek*, 816 F.2d 1057, a municipality attempted to condemn property of a water association financed in part by the Farmers' Home Administration ("FmHA") under a federal program. The district court granted FmHA's motion for summary judgment because the water association was indebted to FmHA, and federal statute, 7 U.S.C. § 1926(b), prevented municipal condemnations of property owned by federally indebted water associations.

In affirming the district court the Fifth Circuit cited the opinion of *Big Bend* and emphasized that the Supremacy Clause prevents municipalities from condemning property Congress has protected from being removed from its role in a federal program stating:

> The case at bar exemplifies the evil Congress wished to avoid. [The association's] affidavits showed that [the municipality] desires to condemn . . . the most densely populated (and thus most profitable) territory now served by [the association]. Even if fair value is paid for the loss of the facilities, such an action would inevitably have an adverse effect on the remaining customers . . . in the form of lost economies of scale resulting in higher per user costs. To allow expanding municipalities to 'skim the cream' by annexing and condemning those parts of

> the water association with the highest population density (and thus the lower per use cost) would undermine Congress' purpose of facilitating inexpensive water supplies for farmers and other rural residents and protecting those associations' ability to repay their FmHA debts. See *Big Bend*, 618 F.2d 601 (9th Cir.1980) (Similarly rejecting utilities attempt to condemn property owned by cooperative finance by REA).

Id. at 1060.

Morgan City and the amici curiae, American Public Power Association, the National Institute of Municipal Law Officers and the National League of Cities argue that the cases from the Ninth Circuit are no longer good law as they were decided prior to the Supreme Court's decision in *Arkansas Electric Co-op Corp. v. Arkansas Public Service Commission*, 461 U.S. 375, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983) and that case *sub silentio* reversed or overruled the previous cases decided by the Ninth Circuit concerning § 907. After a review of *Arkansas Electric* this Court finds that § 907 was not at issue, rather, *Arkansas Electric* addressed a state regulatory body's jurisdiction over cooperatives. Further *Arkansas Electric* only addresses express and field preemption, neither of which is relevant to this case involving preemption by conflict. *Arkansas Electric*, *supra*, at 388, 103 S.Ct. at 1914. Indeed, the Fifth Circuit specifically embraced the Supremacy Clause preemptive exclusion of *Big Bend* in 1987, some four (4) years *after Arkansas Electric* was decided. *Bear Creek*, *supra* at 1060. Therefore, this Court considers the Ninth Circuit opinions concerning § 907 to be good law and adopts the rationale which supports both the two Ninth Circuit cases and the Fifth Circuit's opinion in *Bear Creek*, supra.

State laws are preempted if their operational effect is to "disturb" or "interfere with" a federal program or activity regulated by federal statute. *California v. F.E.R.C.*,

495 U.S. 490, 506-7, 110 S.Ct. 2024, 2033-34, 109 L.Ed.2d 474 (1990). As stated, state law is preempted by conflicting federal law even if the federal law contains no preemptive language, reflects no Congressional intent to preempt, and impacts transactions traditionally regulated by state laws, including transactions involving real property. *Michigan Canners & Freezers Assoc., Inc. v. Agricultural Marketing & Bargaining Board*, 467 U.S. 461, 469-70, 104 S.Ct. 2518, 2523, 81 L.Ed.2d 399 (1984).

The REA, in order to provide the long term capital needed for the construction of the costly generation and transmission facilities which provide the Generation and Transmission Cooperatives ("G & Ts") member distribution cooperatives with economic long term power, must determine that the security for the various loans is "reasonably adequate." 7 U.S.C. § 904.

Congress, in the REAct gave the REA the right to protect a declared national interest in electrifying rural America and a small measure of safety for ensuring continued existence of the "reasonably adequate" security upon which it bases its decision to make a long term loan. That measure is contained in 7 U.S.C. § 907.

As previously stated, the courts are uniform in holding that 7 U.S.C. § 907 requires approval of the REA as a pre-requisite to proposed expropriation. Without the required approval, cooperatives subject to the REAct cannot sell or dispose of assets by any means, contrary state law notwithstanding. The Court in *Pend Oreille, supra,* stated:

> "Congress has declared the federal purpose to electrify the American farm. No matter how we characterize the vehicle which gets the electricity there, a state law so written that a state favored utility can by its unilateral action interfere with the federal pur-

pose cannot stand under the Supremacy Clause of the Constitution of the United States."

Pend Oreille, 417 F.2d at 202.

Similarly, in *Big Bend*, supra the court reasoned:

"The purpose of the Act is to provide low cost electricity to rural America." *Big Bend*, 618 F.2d at 603. Additionally, but in no way controlling, this Court cannot ignore the potential of similar action by similarly situated communities and the resultant destructive impact on the REA and its stated purpose. Therefore, based upon jurisprudence cited, this Court finds to allow the expropriations would be in direct conflict with and thwart the explicit congressional purpose of the REA. The City of Morgan City expropriation must fall.

City of Morgan City also directs this Court's attention to a state court decision, *City of Rochester v. People Cooperative Power Association, Inc.*, No. C090281 (Minn. 3rd JDC, Olmstead City) for the proposition that Louisiana's expropriation law does not conflict with § 907. The case involved Minnesota's "Quick Take" law which was seeking to condemn, immediately, certain cooperative service rights conferred by state law. Defendants challenged the "Quick Take" law on the grounds that it conflicted on its face with § 907 and was invalid. This case is readily distinguished from the one at issue here, as the REA had issued no administrative decision in the Minnesota case which determines that the proposed condemnation would decrease the ability of the REA to achieve the purpose of the REAct. Further, in apparently almost three years since the Minnesota action began, the Administrator had conducted no analysis, economic or otherwise, to determine what the effect would be on the Peoples or the rural electrification system if Peoples lost the right to service some of its facilities. Further, this Court finds that the Minnesota case is far from a final determination as it is presently on appeal in the higher

courts of Minnesota. Therefore, this Court declines to follow the holding in *City of Rochester*.

In the instant case, the REA has made a determination that the City of Morgan City's proposed condemnation would decrease the ability of the REA to serve its purpose. City of Morgan City disputes this determination and contends that the proposed condemnation would actually facilitate rural electrification by making the distribution of electricity more efficient. City of Morgan City contends that because the issue of the wisdom of the taking is disputed, the district court erred in granting a summary judgment to the United States in *Big Bend*. The argument does not follow.

REA is the administrative agency charged by Congress with the responsibility for facilitating rural electrification. REA was intended by Congress to determine the appropriate course of conduct to accomplish the legislative purpose. Courts properly give wide latitude to agency determinations in their areas of expertise. *See National Broadcasting Co. v. Federal Communications Commission*, 516 F.2d 1101, 1122 (D.C.Cir.1974) *cert. denied sub nom., Accuracy in Media, Inc. v. National Broadcasting Co.*, 424 U.S. 910, 96 S.Ct. 1105, 47 L.Ed.2d 313 (1976). The standard of review for administrative agency determination is one of arbitrary, capricious, or an abuse of discretion. *See* 5 U.S.C. § 706. Therefore, after determination that the REA has the authority to withhold approval of an expropriation, this Court is not to revisit the merits of the argument presented to the REA rather is to review the administrative agency actions for procedural validity and under an arbitrary and capricious and/or abuse of discretion standard of review. The administrator of the REA through staff reviewed the issues and issued a 28 page report with numerous attachments and studies. As a result of and/or within this study, the administrator withheld this approval of the proposed expropriation. Full explanation was made

in the 28 page report. Upon review, the administrator's decision cannot be said to be arbitrary and capricious or an exercise of abuse of discretion, particularly given the value of the property to be expropriated versus the proposed payout, the selection of the City of the densest service population of SLECA for expropriation and the resultant negative impact on SLECA of the expropriation. This is discussed further in review of the Magistrates' ruling below.

Appeal of Magistrate's Ruling

In the Magistrate's decision of October 22, 1992, Magistrate Judge Methvin found that the Administrator's decision withholding approval for the expropriation was proper and that no authority required that the REA conduct an evidentiary hearing before issuing a decision under § 907. Agency action taken without a formal evidentiary hearing, but based on an administrative record and subject to judicial review on the basis of that record is constitutional. *Marsh v. Oregon Natural Resources Council*, 490 U.S. 360, 375-377, 109 S.Ct. 1851, 1860-61, 104 L.Ed.2d 377 (1989).

In this matter the REA compiled a very thorough administrative record and granted an exhaustive decision in which it independently verified and analyzed the facts and logic underlying the submissions by various parties. Therefore, when an agency's determination is based on the administrative record, as in this case, the administrative decision should be reviewed in the light of that record. *Bowles v. U.S. Army Corps of Engineers*, 841 F.2d 112, 116 (5th Cir.) *cert. denied*, 488 U.S. 803, 109 S.Ct. 33, 102 L.Ed.2d 13 (1988).

Judicial review is limited to a review of the administrative record and may only be remanded to the REA for further consideration if this Court finds the decision was arbitrary and capricious in light of the record as a matter of law. The burden of establishing that an agency's

actions are arbitrary and capricious lies with the party objecting to it. *Electronic Data Systems Corp. v. N.L.R.B.*, 938 F.2d 570, 573 (5th Cir.1991). This Court finds in a review of the decision rendered on behalf of the REA opposing the expropriation that the decision was not arbitrary and capricious rather that the authority was withheld to prevent a dissipation of the security for loans made by the REA to both SLECA through Cajun.

This Court notes that the federal government, through the REA, has loaned directly or guaranteed loans to Cajun of approximately $3.2 billion. The federal government's security for these loans is limited to the assets of Cajun and the revenue stream resulting from the sale of electric power generated by the facilities constructed by Cajun to its members/owner distribution cooperatives, including SLECA, under the All Requirements Wholesale contracts. Loans for the construction of multi-million dollar generating plants were made on the basis of existing load and anticipated future load of SLECA and Cajun's other member distribution cooperatives with the expectation that those loads would continue and grow in order to generate the revenue stream necessary to repay the loans. The report by the REA details the backgrounds of both Cajun and SLECA including the financial stability of the cooperatives, which is of particular concern to the United States considering the $3.2 billion debt involved. The REA made a detailed analysis of the ability of Cajun and SLECA to repay these loans and the impact of the proposed expropriation on this repayment. Further, the expropriation would result in a loss of operating margins, as the customers sought to be expropriated by the City of Morgan City are located in SLECA's highest density service area. Therefore, expropriation of these customers would reduce the payment base and thereby force higher rates on those being served in less dense areas, thereby frustrating the original intent of the REA, i.e., to provide affordable electric service to

the rural areas of this country. Further, the expropriation by stripping SLECA's densest service area could place repayment itself in jeopardy.

Therefore, this Court finds that the REA administrator compiled an administrative record more than 300 pages in length fully detailing its decision, and that the decision issued on behalf of the agency and approved by the administrator was not arbitrary and capricious. The decision of the Magistrate will be UPHELD by this Court.

Further, this Court also finds that the Rural Electrification Act, 7 U.S.C. § 901's stated purpose is to facilitate rural electrification and as a part of its programmatic interest gave the REA Administrator in 7 U.S.C. § 907 the power to approve or withhold approval of disposal which thwarts this purpose, by any means, including condemnation of the REA financed electric cooperative property under state laws. Any holding to the contrary would severely hinder and jeopardize the REA's ability to protect either the security for its loans and loan guarantees or the overall rural electrification program.

Therefore, considering the foregoing, this Court GRANTS the Motions to Dismiss filed on behalf of the United States of America, the South Louisiana Electric Cooperative Association, and Cajun Electric Power Cooperative, Inc. This Court DENIES the motion for Partial Summary Judgment filed on behalf of the City of Morgan City. Further, this Court DENIES the appeal from Magistrate Judge Methvin's ruling dated October 22, 1992 filed on behalf of the City of Morgan City. The Motion to Strike Documents filed on behalf of the United States of America is rendered MOOT.

THUS DONE AND SIGNED.

APPENDIX C

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 93-4295

CITY OF MORGAN CITY,
Plaintiff-Intervenor-Defendant-Appellant,

v.

SOUTH LOUISIANA ELECTRIC COOPERATIVE ASSOCIATION,
Defendant-Intervenor-Appellee, Third Party-Plaintiff-Appellee,

and

CAJUN ELECTRIC POWER COOPERATIVE INC.,
Intervenor-Plaintiff-Appellee,

and

UNITED STATES OF AMERICA, thru Rural Electrification Administration (REA),
Third Party-Defendant-Appellee.

Appeal from the United States District Court
for the Western District of Louisiana

April 3, 1995

ON PETITION FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC

Before POLITZ, Chief Judge, DAVIS and WIENER, Circuit Judges.

PER CURIAM:

We deny Morgan City's petition for rehearing in this case.[1] We take this opportunity, however, to address a number of Morgan City's arguments.

Morgan City first argues that we have created a far-reaching "per se" rule of preemption that is inconsistent with the Supreme Court's decision in *Arkansas Electric Coop. Corp. v. Arkansas Public Service Commission,* 461 U.S. 375, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983). The *Arkansas Electric* case is distinguishable. In that decision, a rural electric cooperative mounted a facial challenge to a state's right to regulate a rural cooperative's wholesale electric rates. The Court held that the Rural Electrification Act ("REAct"), 7 U.S.C. § 901 et seq., does not preempt a state's "mere assertion of jurisdiction" to regulate a cooperative's rates. *Id.* at 389, 103 S.Ct. at 1915.

In the present case, SLECA does not assert a facial challenge to a state's power to regulate or expropriate a rural cooperative's service area and equipment. Rather, SLECA challenges actual expropriations of its specific property and service rights. Morgan City's characterization of our decision as creating a "per se" rule of preemption is therefore mistaken. The panel's preemption analysis focussed on the actual effect of these specific expropriations, not whether the REAct facially preempts all attempts by states to expropriate the property of a rural cooperative. Significantly, *Arkansas Electric* confirms that concrete action taken by a state "may so seriously compromise important federal interests, **including the ability of the [coop] to repay its loans,** as to be implicitly preempted by the Rural Electrification Act." 461 U.S. at

---

[1] *City of Morgan City v. South Louisiana Elec. Coop. Ass'n,* 31 F.3d 319 (5th Cir.1994).

389, 103 S.Ct. at 1915 (emphasis added). Morgan City's argument is thus unavailing.

Morgan City argues next that the language of the REAct does not create a federal purpose which could be frustrated if the threatened condemnation were allowed to proceed. We disagree. The language of 7 U.S.C. § 907 reflects Congress' concern that piecemeal disposition of a cooperative's property and service rights might impair the Rural Electrification Administration's ("REA") security interest in the cooperative's assets. Section 907 prohibits a cooperative or other entity that borrows funds from the REA from "sell[ing] or dispose[ing] of its property, rights, or franchises" without the agency's prior approval. In the panel opinion, we declined to decide whether § 907 should be interpreted broadly enough to allow the REA to prevent a proposed expropriation.[2] However, at the very least, the provision reflects a general federal policy of protecting the integrity of the REA's security interests. Thus, even a narrow interpretation of § 907 supports the panel's preemption analysis.

Finally, we reject Morgan City's contention that the record does not support the panel's conclusions. SLECA's summary judgment evidence includes a copy of a comprehensive twenty-eight page report on the effect of proposed expropriations prepared by the REA, the agency charged with administering the REAct. The report considered not only the number of SLECA's customers affected by the expropriations, but also the extent to

---

[2] The Ninth Circuit has suggested in two decisions that § 907 might authorize the REA to block a proposed expropriation. In both decisions, however, the court ultimately based its holding on the fact that the proposed condemnation frustrated a federal purpose. *See Public Utility District No. 1 of Franklin County v. Big Bend Elec. Coop., Inc.*, 618 F.2d 601, 603 (9th Cir.1980); *Public Utility District No. 1 of Pend Oreille County v. United States*, 417 F.2d 200, 200-202 (9th Cir.1969).

which these customers accounted for a large percentage of SLECA's revenues because of the density of the service area involved. The report concludes that the planned condemnations would reduce SLECA's gross revenues by $768,000 annually and decrease its system operating margins by 88.26%. In assessing the effect of the condemnations, the REA also considered future planned expropriations by Morgan City (the Phase III Plan) and the nearby City of Houma.

Morgan City's summary judgment affidavits fail to effectively rebut the REA report's detailed findings. Morgan City's primary contention is that the panel should not have considered the proposed future expropriations in assessing the impact on SLECA. However, these proposed condemnations were not merely hypothetical threats. SLECA points to testimony by Morgan City's mayor that Phase III was fully planned and ready for implementation. The REA report also points to statements by Houma city officials revealing that the city planned to expropriate SLECA's adjoining service area. These planned future expropriations were thus highly relevant to assessing the overall impact of the expropriations on SLECA. If courts are not allowed to consider fully planned future expropriations under these circumstances, states and municipalities could escape preemption by merely dividing planned expropriations into incremental phases that, when considered individually, are insufficient to invoke preemption.

For these reasons, Morgan City's petition for panel rehearing is DENIED.

A member of the court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service not having voted in favor, rehearing en banc is DENIED.

EDITH H. JONES, Circuit Judge, with whom, JERRY E. SMITH and DeMOSS, Circuit Judges, join dissent from the Denial of Rehearing En Banc:

The panel opinion and opinion on rehearing in this case have, under the rubric of "frustration preemption," [1] approved a breathtaking federal power-grab by REA from local government units that otherwise enjoy broad eminent domain authority. Neither the REA nor its regulations contemplate preemption of this quintessential local power—the agency's regulations in fact assume the opposite.[2] That REA lacks broad preemptive authority was emphasized by the Supreme Court's rebuff of agency efforts to thwart local electrical rate regulation. *Arkansas Electric Cooperative v. Arkansas Public Service Commission*, 461 U.S. 375, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1982). Surely, if state rate regulation is permitted, though it contains the power to hobble a federally financed cooperative,[3] then the eminent domain power—exercisable only on payment of just compensation—has not been overridden by statute or, even more vaguely, by a conclusional judicial stamp labelled "frustration of purpose." Because the panel opinion has given REA authority that Congress clearly denied it and that the Supreme Court, I am confident, has also withheld, I respectfully dissent from the denial of *en banc* rehearing.

---

[1] "Frustration preemption" is employed as a short-hand reference for the proposition that state law is (impliedly) preempted when, though it does not conflict with a federal statute, it would unduly frustrate the purposes of such a statute by "discouraging conduct that federal legislation specifically seeks to encourage." *Morgan City*, 31 F.3d at 322.

[2] *See* 7 C.F.R. § 1710.12(b)(5) (Administrator to account for risks "of loss of portions of borrower's service territory from annexation" in assessing likelihood that loan will be repaid.)

[3] Cajun Electric Power Co., an REA-financed supplier of electricity to SLECA and participant in this case, recently entered bankruptcy proceedings in part because of niggardly local rate regulation.

By relying on the notion of frustration preemption, the original panel opinion held that Morgan City's attempted annexation of customers from SLECA, an REA-financed rural electrical cooperative, must fail because it might impair SLECA's ability to repay REA's loans. Curiously, that opinion never cited *Arkansas Electric*, the critical Supreme Court decision concerning preemption of local regulatory authority under the Rural Electrification Act. Only in its rehearing opinion does the panel attempt to grapple with the implications of *Arkansas Electric*. To me, that case is fatal to the panel's decision.

In *Arkansas Electric*, the Supreme Court rejected an implied preemption argument nearly identical to that advanced here. REA argued that local rate regulation may "frustrate important federal interests":

> [I]n passing on rate questions, the REA considers, not only the security thus afforded for payment of the loan, but also the suitability of the rates and structure to the Act's underlying purpose of facilitating the availability of cheap electric power in rural America.
>
> . . . . .
>
> The spectre of state regulation poses a threat to the REA loan because of the possibility that the state may refuse to permit its cooperatives to pay a generation and transmission association the rates to which they agreed and upon the security of which the loan was issued. Moreover, the policy behind the Rural Electrification Act is at stake . . . [T]he REA has always encouraged its borrowers to establish affordable rates for all of its subscribers. In this way, costs are shared in a manner which, over the long run, benefits all by the creation of a sound, extensive rural electric system.

Arkansas Electric, 461 U.S. at 385-386, 103 S.Ct. at 1913 (omissions in original).

To REA's policy arguments, the Court responded, first, that, "[A]lthough the REA was expected to play a role in assisting the fledgling rural power cooperatives in setting their rate structures, *it would do so within the constraints of existing state regulatory schemes.*" *Arkansas Electric*, 461 U.S. at 386, 103 S.Ct. at 1913 (citing legislative history of 1936 Act) (emphasis added). Second, the Court noted that REA's presently published policy was inconsistent with preemption of state regulatory jurisdiction. *Id.* at 387-88, 103 S.Ct. at 1914. Third, responding to the possibility that state regulation of rates could jeopardize "the Government's interest in securing its loans," the Court observed: "The relevant inquiry, however, is not whether Congress authorized or expected such regulation, but whether it intended by its own actions to *forbid* it." *Id.* at 387 n. 11, 103 S.Ct. at 1914 n. 11 (emphasis in original).[4]

The premises of decision in *Arkansas Electric* govern the case before us. Just as the Supreme Court held that the structure of the REA implies coexistence of the agency's program with local electrical rate regulation, that same structure commands coexistence with local eminent

---

[4] *See also Commonwealth Edison v. Montana*, 453 U.S. 609, 633-34, 101 S.Ct. 2946, 2961-62, 69 L.Ed.2d 884 (1981) (rejecting that general statements of national policy can demonstrate congressional intent to pre-empt state legislation that may have an adverse impact on attainment of that policy objective). "[P]re-emption of state law by federal statute or regulation is not favored in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained." *Id.* at 634, 101 S.Ct. at 2962 (citations omitted). "In cases such as this, it is necessary to look beyond general expressions of 'national policy' to specific federal statutes with which the state law is claimed to conflict." *Id.* Nor is this requirement limited to facial challenges. *Id.* at 633, 101 S.Ct. at 2961-62. The appellants in *Commonwealth Edison* "insist[ed] that they [we]re entitled to a hearing . . . to adduce evidence supporting their claim that the "state action" frustrates and impairs" the national policy of encouraging the use of coal." *Id.*

domain authority.[5] As in *Arkansas Electric,* no statutory provision precludes the exercise of the local expropriation power. The panel's attempt to resurrect, in the opinion on rehearing, 7 U.S.C. § 907 as a source of implied preemptive authority is simply incorrect.[6] That provision permits REA, like any lender, to prevent voluntary alienation of its collateral by the borrower; it says nothing about REA's ability to forestall *involuntary* condemnation of service territory. Under *Arkansas Electric,* local governmental units plainly retain their right to condemn REA-backed cooperatives' assets.

In their rehearing opinion, the panel has belatedly placed a fig leaf over its conflict with *Arkansas Electric,* distinguishing that case as a facial challenge to local regulation, while Morgan City's case involves an alleged actual conflict wrought by specific expropriations of SLECA's customers. As the panel observes, *Arkansas Electric* did not entirely foreclose the possibility that a particular rate may so seriously compromise federal interests, including the ability to repay loans, as to be impliedly preempted. *Id.* 461 U.S. at 389, 103 S.Ct. at 1915. For several reasons, this argument is unpersuasive. First, whether there is an actual conflict that "frustrates the ability to repay REA-backed loans" raises a factual question. Yet no hearing or trial occurred here, despite conflicting affidavits of competent experts on both sides.[7] Second, the trial court did not view this as a factual but

---

[5] *Compare City of Madison v. Bear Creek Water Ass'n.,* 816 F.2d 1057 (5th Cir.1987) (federal statute unambiguously barred annexation or condemnation.).

[6] Although the district court relied on § 907, the original panel opinion pointedly declined to do so. 31 F.3d 319.

[7] Letters by the administrator of the REA cannot suffice to ordain preemption. *Wabash Valley Power Association v. REA,* 903 F.2d 445, 453 (7th Cir.1990). ("In order to preempt state authority, the REA must establish rules for the force of law."); *Thomas v. New York,* 802 F.2d 1443 (D.C.Cir.1986) (Scalia, J.) (holding that a letter from the Administrator of the EPA does not have force of law). "We have not found any case holding that

as a purely legal dispute. *See City of Morgan City v. South Louisiana Electric*, 837 F.Supp. 194, 199 (W.D. La.1993) (review of REA's withholding approval decision under § 907 limited to "arbitrary and capricious in light of the record as a matter of law"). Third, REA's and SLECA's fears of conflict between federal and local authority are utterly hypothetical, because they predict dire domino-like consequences of future expropriations if even one be allowed to occur, and because they essentially assume that in no expropriation will local regulations adequately reimburse SLECA with just compensation. Fourth, and most tellingly, if the condemnation of 252 customers, a mere one percent of those served by SLECA, "frustrates" a federal purpose, then what exercise of eminent domain would not do so? The practical effect of the panel's decision is much broader than its self-deprecating language would suggest. Because the panel has not based its decision on a factual finding of "frustration" so much as upon a rubber-stamp of an agency conclusion,[8] the real frustration here is of the *Arkansas Electric* holding.

What particularly troubles me about this case is the panel's willingness to allow a federal lending agency to get more than its due at the expense of local sovereignty. REA claims the authority to override municipal condemnation authority because otherwise, it asserts, SLECA's operating costs may rise and may necessitate higher rates to customers and jeopardize SLECA's ability to repay its federal loans. The Seventh Circuit pointedly answered

---

a federal agency may preempt state law without either rulemaking or adjudication." *Id.*

[8] Interestingly, the Court itself sounded warning about the need to discount the REA's preferences: "All this is not to say that officials of the REA have always welcomed state regulation of rural power cooperatives, or thought it was a good idea. But, of course, such expressions of opinion do not constitute sufficient grounds for pre-emption." *Arkansas Electric*, 461 U.S. at 386 n. 10, 103 S.Ct. at 1913 n. 10 (citation omitted).

such arguments: "To the extent the REA believes that states must adopt rules of the law that always allow federal lenders to recoup their investments, it is mistaken." *Wabash Valley Power Ass'n v. REA*, 903 F.2d 445, 454 (7th Cir.1990) (citing *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 99 S.Ct. 1448, 59 L.Ed.2d 711 (1979)). Further, "Congress' assumption when it created the Rural Electrification Act in 1936 seems to have been that the REA could protect itself [from this parade of horribles] by setting conditions on the extension of credit." *Wabash Valley Power Ass'n*, 903 F.2d at 453 (holding that direct, invasive regulation of state utility rates was not preempted).[9]

Even the core of the panel's opinion—preemption premised in frustration of a federal purpose—is highly problematic, rarely utilized by the Supreme Court and of dubious propriety.[10] As Judges Higginbotham, Sey-

---

[9] Judge Easterbrook also noted the economic windfall reaped by the REA by virtue of its preemption argument:

> [T]he REA made its loans and guarantees on the assumption that state regulation would apply. . . .
>
> [This] may have led to an adjustment in the interest rate, which, in turn increases the rates [the utility] charges. (If there was no adjustment, people at the REA were asleep on the job.) When the risk materialized, the REA has demanded shelter of federal law *plus* the interest rate that reflected the interest risk created by state law. Nice cushion, if you can get it.

Wabash Valley, 903 F.2d at 455.

[10] *See also* Stephen A. Gardbaum, *The Nature of Preemption*, 79 Cornell L.Rev. 767 (1994), who argues that the vitality of this strain of preemption hinges on confusing the Supremacy Clause and preemption. On the one hand, the supremacy of the federal law means that valid federal law overrides otherwise valid state law in cases of conflict between the two. Hence supremacy does not deprive the state of any of its preexisting concurrent lawmaking authority, but merely dictates that a particular state law in conflict with a particular federal law will be trumped in cases where both apply. Preemption, by contrast, means (a) that states are deprived of their power to act *at all* in a given area, and (b) that this is so *whether or not* state law is in conflict with federal law.

mour, Sneed, and then-Judge Starr, Justices William C. Clark and John Criswell have observed, "obstacle preemption demands a high degree of judicial policymaking." The LAW OF PREEMPTION, a Report of the Appellate Judges Conference American Bar Association at 38 (1991).

The effect of this decision must be to embolden federal lending agencies to overcome costly or inconvenient local regulations by advancing newly-minted frustration of purpose arguments in federal court. Such an extension of this type of implied preemption doctrine is an unwholesome development because it takes power away from

—Congress, which carefully described the agency's authority;

—the administrative rule-making process, which could preempt local regulation *after* allowing all affected parties to participate; and

—local, politically responsible authorities.

The panel decision transfers power to

—REA officials, without benefit of express statutory authority or regulation;

—federally financed rural electrical coops, who must be surprised at this development; [11] and

—federal judges, who have the final, delphic say in what constitutes a "frustration of purpose."

"Frustration of purpose" preemption should not be allowed drastically to expand a federal lending agency's authority where Congress expressly contemplated it would play by local regulatory rules.

I respectfully dissent.

---

[11] In an amicus brief filed with this case in October, 1993, the National Rural Electrical Cooperative Association attached a "Final Report of the Territorial Integrity Committee," which explains and complains about how many municipal annexations of members' property were occurring in the late 1980's.

APPENDIX D

IN THE UNITED STATES DISTRICT
FOR THE WESTERN DISTRICT OF LOUISIANA
LAFAYETTE-OPELOUSAS DIVISION

Civil Action No. ———
Section L

JUDGE DOHERTY
MAGISTRATE JUDGE METHVIN

CITY OF MORGAN CITY,
Plaintiff

v.

SOUTH LOUISIANA ELECTRIC COOPERATIVE ASSOCIATION,
Defendant,

CAJUN ELECTRIC POWER COOPERATIVE, INC.
Defendant/Intervenor

and

UNITED STATES OF AMERICA,
Third-Party Defendant.

DECLARATION OF MICHAEL F. LIU

I hereby declare under penalty of perjury that the following is true to the best of my knowledge, information, and belief.

1. My name is Michael M. F. Liu. My current title is Acting Administrator of the Rural Electrification Administration ("REA").

2. Attached is an authentic copy of the administrative decision which I made as Administrator with respect to the proposed expropriation of property of South Louisiana Electric Cooperative Association ("SLECA") by the City of Morgan City in this case.

3. Under section 7 of the Rural Electrification Act of 1936, as amended, I have determined to withhold approval of the disposition of SLECA property which is the subject of the expropriation action in this case.

/s/ Michael M. F. Liu
MICHAEL M. F. LIU

6/18/92
Date

TABLE OF CONTENTS FOR

RECOMMENDATION TO THE ADMINISTRATOR

LOUISIANA 8 TERREBONNE

LOUISIANA 30 BAYOU GT

EXPROPRIATION BY MORGAN CITY, LOUISIANA

I. Purpose ..... [38a]

II. Background ..... [38a]

A. SLECA Background ..... [38a]

B. Cajun Background ..... [41a]

1. General ..... [41a]

2. Wholesale Power Contracts ..... [42a]

3. Financial Difficulties ..... [43a]

4. Debt Restructure ..... [45a]

C. Expropriation Background ..... [47a]

D. REA Program ..... [50a]

1. Distribution Borrowers ..... [50a]

2. Power Supply Borrowers ..... [54a]

III. SLECA Impact Analysis ..... [58a]

A. Phase II ..... [58a]

1. Lost Margins ..... [60a]

2. Severance Damages ..... [60a]

3. Consequential Damages ..... [61a]

4. Expropriated Facilities ..... [61a]

B. Phase III ..... [62a]

C. Houma Expropriation ..... [63a]

D. Consolidated Impacts on SLECA ..... [64a]

E. Other Impacts ..... [65a]

IV. Cajun Impact Analysis ..... [67a]

A. Analysis of Expropriation Impacts ..... [67a]

1. Cajun Analysis of Expropriations ..... [67a]

2. REA Analysis of Expropriation ..... [69a]

B. Overall Impact on Cajun ..... [70a]

V. Summary ..... [72a]

VI. Conclusion ..... [74a]

RECOMMENDATION TO THE ADMINISTRATOR
LOUISIANA 8 TERREBONNE
LOUISIANA 30 BAYOU GT
EXPROPRIATION BY
MORGAN CITY, LOUISIANA

I. Purpose:

This memorandum analyzes the impact on South Louisiana Electric Cooperative Association ("SLECA") and Cajun Electric Power Cooperative, Inc. ("Cajun") of plans of the City of Morgan City, St. Mary Parish, Louisiana ("Morgan City"), to expropriate all of SLECA's electric distribution facilities and consumer/members within the existing City limits and to annex additional land area and expropriate additional facilities and consumers from SLECA. This recommendation also analyzes, in detail, the effects that the Morgan City and potential takings of SLECA consumer/members and facilities would have on the interests of REA, and recommends how the Administrator's discretionary approval rights under Section 7 of the Rural Electrification Act of 1936 (RE Act) be exercised.[1]

II. Background:

A. *SLECA Background*: SLECA is a distribution cooperative headquartered in Houma, Terrebonne Parish, Louisiana. It provides service in the peninsula region of the extreme southeastern portion of the State. SLECA serves the power requirements of approximately 15,000 Members in the parishes of Lafourche, Saint Martin, Saint Mary, and Terre-

---

[1] SLECA is opposing the proposed expropriation and has not sought REA approval for the expropriation. Therefore, the procedure in REA Bulletin 115-1, *Sales of Capital Assets by Electric Borrowers*, for approving capital sales are not applicable.

bonne. SLECA has a density of consumers of nearly 13 per mile of line.

Over the past 55 years, REA has financed the construction of SLECA's electric system. Since February 3, 1937, SLECA has received 25 REA loans totaling over $38,000,000 and supplemental financing from other lenders of over $12,000,000 to construct 1,108 miles of distribution line, 36 miles of transmission line, and connect over 18,000 services. The REA loans are long-term (35 years) and bear interest at subsidized rates of from 2 to 5 percent. The most recent insured/concurrent loan, designated "AD6", was approved for

SLECA on April 23, 1984, totaling $6,460,000 from REA and $2,914,000 from the National Rural Utilities Cooperative Finance Corporation ("CFC"). As of December 31, 1991, SLECA's long-term outstanding debt was $34,359,109, of which $25,184,401 is to REA and $9,174,708 to CFC. The REA loans will reach final maturity in 2014.

Per Capita Personal Income Statistics from the Bureau of Labor Statistics:

	Per Capita Personal Income 1989
United States	$17,592
Louisiana	$12,923
Lafourche Parish	$12,091
St. Martin Parish	$ 9,585
St. Mary Parish	$11,509
Terrebonne Parish	$11,641

This data shows that SLECA serves a relatively low income area compared to both the national and Louisiana statistics.

SLECA purchases all of its power requirements from Cajun through a wholesale power contract that extends through December 31, 2026.

SLECA's key financial ratios and other statistics, which have been obtained from REA's report number 168.1, *Borrower Statistical Profile* and REA Form 7, *Financial and Statistical Report* submitted to REA by SLECA for the period ending December 31, 1991, are as follows:

	SLECA Annual values			Median values U.S.	State
	1989	1990	1991	1990	1990
*TIER	1.24	1.59	1.63	2.23	1.63
*MTIER	1.21	1.55	1.55	1.97	1.59
*DSC	1.35	1.60	1.52	2.16	1.61
*MDSC	1.32	1.57	1.44	2.00	1.61
*Equity	27%	30%	32%	39%	29%
Consumers	14,699	14,854	15,047	8,248	14,149
*MWh Sale	319,800	340,110	352,130	129,750	219,840
Sales Rev/MWh	79.08	78.28	76.05	73.10	86.15

* See "Definitions" in Attachment A. The definition of "MWh" is included in the Attachment.

SLECA and the other REA borrowers in Louisiana compete with other types of electric utility enterprises for consumers. There are no certificated electric service territories, as such, in Louisiana. Thus, the relative competitiveness of SLECA's retail rates is important to SLECA's financial health. In addition to Morgan City and the City of Houma Electric System ("Houma"), SLECA competes with the following Louisiana investor owned utilities:

Central Louisiana Electric Company ("CLECO") and Louisiana Power and Light ("LP&L").

SLECA has provided REA a summary showing the disparity in residential consumer electric service bills among the electric utilities in Louisiana as of April 1992. The summary shows SLECA's average residential revenue per 1000 kWh sold was $76. That bill amount was 27 percent higher than CLECO's, 7 percent higher than LP&L's, 15 percent higher

than Morgan City's, and 1 percent higher than Houma's.

B. *Cajun Background*:

1. *General*: Cajun is a nonprofit generation and transmission cooperative association, incorporated under the laws of the State of Louisiana and comprised of 13 distribution cooperatives ("Members"), including SLECA. Each Member is represented on Cajun's Board of Directors. Cajun supplies wholesale electric power to each of its Members pursuant to an all requirements wholesale power contract with each Member, requiring that the Member buy all of its power from Cajun. Cajun also sells wholesale electric power to other utilities and municipalities which are not Members. The Members are located in Louisiana and provide retail electric power to customers in most of the Parishes in Louisiana.

Cajun is headquartered in Baton Rouge, Louisiana. Cajun was originally organized in 1960, as the Louisiana Electric Cooperative, Inc. (LEC), and in July of 1962, was chartered by the State of Louisiana and incorporated with the objective of assuring member cooperatives a reliable supply of electric power at as low a cost as practicable. In January 1972, LEC changed its name to Cajun Electric Power Cooperative, Inc. (Cajun).

As of December 31, 1991, the Cajun Members served approximately 337,000 metered customers representing over one million people. Members' energy sales in 1991 totaled approximately 5,337,000 MWh, of which approximately 74 percent were to residential customers.

Cajun initially met its Members power requirements by purchasing wholesale electric power from other sources. Uitimately, Cajun and its Members determined that it would be in the Members' best interest to own generating units.

Substantially all of Cajun's capital financial needs have been met through REA programs. Cajun has obtained direct loans and loan guarantees from REA, and, as of January 1, 1992, Cajun's total debt obligation to the United States was in excess of $3.5 billion. Cajun has encountered severe financial difficulties and REA has restructured Cajun debt as discussed in more detail in Sections 3 and 4 below.

2. *Wholesale Power Contracts*: Cajun derived 72 percent of its revenue in 1991 from the wholesale power contracts with its Members. The wholesale power contracts between Cajun and each of its Members provides that Cajun shall sell and deliver to each Member, and each Member shall buy and receive from Cajun, all of the Member's power and energy requirements. The wholesale power contracts, as amended, extend through December 31, 2026. The Members have contracted not to enter into any separate wholesale power contracts or arrange for a supply of any power without the approval of Cajun and REA.

As noted above, sales to Members comprised 72 percent of Cajun's revenue in 1991. Cajun has considerable excess generation capacity and the capability to interchange capacity and energy with utilities in several states in the southern region of the United States. However, the price of capacity and energy which is generally available for sale from other utilities in the region is more competitively priced than the cost to

Cajun to generate and transmit comparable capacity and energy outside its system to purchasing utilities. Cajun is unable at this time to sell very much of its excess capacity and energy. This situation is not expected to improve substantially in the immediate future. Member sales will continue to be the foundation of Cajun's capacity and energy sales and Cajun's viability is directly dependent upon such sales.

Because of Cajun's disadvantaged position in the excess power market in the southern region, it is basically unable to recover the carrying costs of its investment in such excess capacity from either its Members or through non-Member sales. As a result, Cajun experienced severe financial difficulties, which ultimately led to REA restructuring Cajun's financial obligations.

3. *Financial Difficulties*: Cajun has experienced serious financial difficulties which resulted in its inability to make all required debt service payments to REA. Cajun first defaulted on its payments to REA in 1987. Prior to reaching an agreement with REA restructuring its payment obligations, Cajun defaulted on payments amounting to over $427 million. If REA had not agreed to restructure Cajun's payment obligations, Cajun's defaulted payments would amount to over $890 million today.

Cajun's financial difficulties have been caused by several factors. The first is the failure of load growth to reach the levels anticipated during Cajun's building phase. Cajun had built generating units during the last decade which can annually generate over 10,000 GWh. Cajun's energy requirements were based on an anticipated annual load growth of over 9 percent. Instead of experiencing 9 percent annual

load growth, Cajun's growth has been significantly less. During the last 4 years Cajun has experienced annual load growth of about 1.5 percent. As stated above, the Cajun Members' energy load in 1991 was approximately 5,337 GWh in 1991, resulting in approximately 5,000 GWh in excess energy.

The failure to achieve anticipated load growth has obviously had a detrimental effect on Cajun's revenue and has contributed to Cajun's need to increase the rate it charged its Members. Cajun's wholesale rates to its Members reached a peak in 1986 of approximately 65 mills per kWh, or 6.5 cents/kWh. The Louisiana economy, however, was such that the Membership of Cajun could not support such a level of wholesale rates.

Furthermore a large disparity existed between the wholesale power rates charged by Cajun and those charged by Cajun's competitors. This rate disparity made Cajun uncompetitive, further jeopardizing Cajun's economic position. A comparison of Cajun's wholesale electric rates from *Financial Statistics of Selected Utilities* for years 1985 through 1991 and those charged by its competitors are as follows:

Louisiana Firm Power Sales

Mills/KWH 1985-1991

	1985	1986	1987	1988	1989	1990	1991
Cajun	63.7	64.9	60.1	53.5	53.5	54.4	52.5
CLECO	44.7	35.9	31.1	32.4	40.4	45.8	46.2
GSU	NA	50.9	50.5	57.7	58.4	46.0	42.5
LP&L	34.4	36.2	33.8	35.8	37.6	36.3	37.4*
NOPSI	NA	25.8	25.3	27.2	28.3	28.5	29.2*
SWEPCO	38.9	35.4	26.9	24.4	21.8	19.3	20.1*

* = Estimate

Note: GSU and NOPSI 1985 data not available

4. *Debt Restructure*: Since 1987, when Cajun defaulted on its REA debt, REA has worked with Cajun to avoid Cajun's bankruptcy. After long and difficult negotiations, REA and Cajun were successful in concluding a Debt Restructure Agreement (DRA) on May 31, 1990. The DRA restructured Cajun's total REA debt, direct and guaranteed, into two notes containing different repayment terms.

Seventy percent (70%) of the Cajun debt outstanding on May 30, 1991, totaling $2,147,994,670, is evidenced by "Note A." "Note A" has a fixed debt service schedule which requires specified payments to REA in an amount which for many years is significantly less than what would otherwise have been due to REA. At the time of its default in 1987, Cajun's annual debt service payment was approximately $300 million. REA, as specified in "Note A," has agreed to accept a payment schedule substantially reducing Cajun's current annual debt service payments. For example, the "Note A" payment schedule provides for a payment of $120 million in 1992.

Thirty percent (30%) of the Cajun debt outstanding on May 30, 1991, totaling $1,037,007,550, is evidenced by "Note B." "Note B" represents a contingent payment obligation until the final maturity date in 2036, when all unpaid amounts become due. Until the maturity date, payments must be made on "Note B" only if certain revenue-generating events occur, such as load growth. It has been specifically agreed that "Note B" payments are required to be made by Cajun when Cajun's actual Member sales on an accumulated basis exceed those levels established in the DRA.

Cajun's sales during the 2 years following the effective date of the DRA have been greater than the threshold amount of sales above which Cajun must make payments due to REA under Note B. Consequently, REA has received some payments under Note B. Any loss of load currently served by the SLECA system in the areas proposed to be expropriated would reduce directly the amount of payments REA is entitled to receive under the Note B.

The DRA includes major financial concessions by REA. Cajun's current debt service payments have been reduced to a little more than one third of what they were prior to the DRA. While Cajun is making these drastically-reduced debt service payments to REA, REA is fully honoring its guarantee of Cajun's debt to other lenders. Over 98 percent of Cajun's outstanding long-term debt was borrowed from the Federal Financial Bank (FFB)[2] and the National Bank for Cooperatives (CoBank), backed by REA guarantees. REA, as guarantor of this debt, is paying the difference between Cajun's restructured debt service payments and the debt service payments agreed to originally by Cajun and its lenders. REA's payments on behalf of Cajun represent a present outflow of federal funds which may never be recouped if circumstances in Louisiana further deteriorate.

Because of REA's concessions under the DRA, Cajun was able to reduce its wholesale rates. Cajun's average rates to the Members have been the following over the last 5 years:

---

[2] A significant percent of FFB debt has been refinanced. The repayment of such debt is guaranteed by REA.

	Average Rate To Members (mills/kWh)
1987	60.66
1988	53.52
1989	53.47
1990	54.50
1991	52.46

REA's concessions have enabled Cajun to charge rates which are supportable by the Louisiana economy, and which reduce the rate disparity between Cajun's Members and competing utilities. The purpose of this effort is to maintain the viability of the cooperative system in Louisiana while recouping the REA's investment in developing that system.

C. *Expropriation Background*: Morgan City initiated efforts in 1986 through correspondence with SLECA to acquire consumers in a newly annexed area, since referred to as Phase II of a long-range annexation plan. Morgan City has a plan composed of Phase I, Phase II, and Phase III to enlarge its municipal boundary by annexing additional land and to expropriate all of SLECA's electric distribution facilities within the resulting boundaries. Morgan City is located in the Parish of St. Mary, approximately 30 miles west of Houma, Louisiana, where SLECA is headquartered. Phase I of Morgan City's plan has been implemented. That phase did not involve any of SLECA's system's facilities.

In Phase II, Morgan City seeks to take all of SLECA's facilities, including poles, transformers, power switches, and other equipment, located in the area annexed in 1986, as well as the right to serve approximately 260 existing electric consumers who are presently purchasing power from SLECA, and all future consumers located within that area. The por-

tion of SLECA's system which Morgan City proposes to take in Phase II has a density of consumers of about 34 per mile of line in comparison to the system average density of consumers of about 13 per mile of line. If Phase III takes place, it could result in the taking from SLECA of approximately 270 additional electric consumers and related facilities, and service rights to future consumers, being lost by SLECA. Electric service within the Phase II area was initially provided by SLECA as part of the REA loan program and all the property sought by Morgan City was financed with long-term REA loans at subsidized interest rates of from 2 to 5 percent.

In 1987, SLECA sent a letter to Morgan City describing the adverse effects that the Phase II acquisition would have on the remaining SLECA system's members. Morgan City made repeated offers to SLECA during the next 2 years. Morgan City's final offer for the Phase II acquisition was made May 15, 1989, totaling approximately $896,000, as follows:

2½ X Annual Gross Revenue	$735,000
Value of Facilities	$161,000
Total	$896,000

Morgan City proposed to make payments annually over an 8-year period of approximately $112,000 per year. SLECA has not made a counter offer to Morgan City because it wants to retain the consumers Morgan City proposes to expropriate.

On August 3, 1990, Morgan City filed an expropriation, or condemnation, proceeding against SLECA in state court. This legal proceeding involves only Phase II of Morgan City's plan. However, SLECA is concerned that the Morgan City action is not isolated but part of a growing trend by municipalities to acquire the more lucrative portion of SLECA's or other REA borrowers' systems.

REA analyzed the effects of the proposed takings on SLECA, Cajun and REA interests. REA's preliminary assessment combined Phases II and III, and also considered the possibility of the threatened expropriation by the City of Houma, which has indicated an interest in acquiring SLECA's consumers and facilities within its city limits. A copy of the preliminary analysis prepared by the Financial Services Staff to determine the effect the expropriations could have on Cajun is attached as Attachment B. The preliminary analysis indicated that in 1992 the combined Morgan City Phases II and III expropriations would result in gross lost revenue from SLECA of $768,000 annually and net lost revenue of $535,000 annually to Cajun.

The preliminary analysis for the loss in 1992 of consumers in the City of Houma showed a gross revenue loss of $882,000 annually and a net loss of $615,000 annually to Cajun. The combined total forecasted lost revenues for Morgan City Phases II and III, and the City of Houma, in 1993, would be gross revenue loss of $1,650,000 annually and net loss revenue of $1,150,000 annually to Cajun.

In the initial REA analysis it was also recognized that in addition to the impact that the expropriations would have upon SLECA and Cajun, there would also be an impact upon the other 12 distribution member systems of Cajun. In light of Cajun's excess generating capacity and precarious financial position, one of REA's major concerns is the effect that the loss of existing consumers and service rights in the targeted areas on rates and financial stability of SLECA, Cajun, Cajun's other Members and on REA's loan program in Louisiana. REA determined, based upon the preliminary analysis by REA staff, that SLECA's, Cajun's, Cajun's other Members' and REA's interests would be adversely effected, and that

the Administrator should strongly consider withholding approval of the disposition of property under Section 7 of the RE Act. (see *"REA Program"* below). This recommendation sets forth in greater detail than the preliminary analysis, the impact of the proposed expropriation and considers additional information provided subsequent to the preliminary analysis.

D. *REA Program*: The expropriations must be evaluated from the perspective of their impact on the objectives of the REA Program, the structure adopted by REA to carry out the Program, and the feasibility of and security for REA loans and/or loan guarantees to SLECA, Cajun, and to other Cajun Members. Congress established REA, and authorized the Administrator to provide long-term low interest rate loans to accomplish the objective of providing reliable electric service at affordable costs in rural areas at a time when existing utilities were refusing to provide service in many rural areas. REA borrowers are organized in a unique corporate and financial structure specifically designed to carry out the RE Act objectives in the most cost effective manner in order to bring out the benefits of rural electrification to as many people as possible.

1. *Distribution Borrowers*: With scattered exceptions, REA distribution borrowers are member-owned, not-for-profit cooperatives organized to provide electric service to qualified persons within their service areas. Through their electric bills, Members pay for the cost of electric service and contribute additional amounts to be used by the cooperative as equity capital. The cooperative allocates the additional amounts to the Members and normally returns contributed capital to its Members periodically, provided it meets certain requirements identified in its mort-

gage with REA. Members do not receive an economic return (e.g., interest or dividends) on equity capital. Rather, the cooperative's ability to utilize member equity contributions "free" allows the Members to benefit through lower rates of electricity.

Central to the goal of the REA program are the principles that electric service will be provided to the widest number of consumers possible, and that the costs and benefits of service will, to the extent practicable, be shared by all Members on the same basis. The organizational structure of the cooperatives and the financial policies of the REA are designed to further those principles. REA approves loans to serve new consumers based on the economics of the borrower's entire service area, including yet undeveloped areas, not just the economics of the new consumers. REA requires, as a term of the loan, that each borrower practice area coverage. Area coverage is the concept whereby a borrower extends electric service to all unserved persons within its service area who meet all reasonable requirements, and that, to the maximum extent practicable, such service be provided to all consumers at the same rates and minimum charges. See 7 C.F.R. 1710.103. As noted in Harl's treatise on *Agricultural Law*:

> "The significance of the area coverage principle is seen from the fact that the RE Act was in large part a reaction against policies of certain power companies in the 1930's to skim off the cream of the electric business in the more densely populated areas and to leave the remote areas without service. This resulted from their considering the

> economic feasibility of each service extension on its own, whereas the REA area coverage concept was to consider economics of service to the entire area without testing each extension separately." 98.02[17](d)(iv), 1984.

The cooperative structure and the area coverage requirement are designed to ensure that all consumers share equally in the costs and benefits of the program for rural electrification, and that the greatest number of rural consumers receive electric service at affordable rates. The rates charged to customers in sparsely populated areas are the same as those in more densely populated areas. The members in low density areas benefit from revenues received from members in higher density areas where costs of service are lower. In time, some of the lower density areas increase in density to the extent that they, in turn, provide benefits to remaining low density areas. The success of this structure depends on the ability of the borrower to continue to serve the densely populated areas of the system—frequently those adjacent to or incorporated into municipalities—which provide greatest returns.

The RE Act imposes on the Administrator the duty to determine that each loan is "feasible" and that "loan security" is reasonably adequate. In addition, REA has been directed by Congress to improve the financial strength of the borrowers. Legislation amending the Act in 1973 provided, in part:

> "It is hereby declared to be the policy of Congress that . . . such rural electric and telephone systems should be encouraged and assisted to develop their resources and

> ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organizations and other sources at reasonable rates and terms consistent with the loan applicant's ability to pay and achievement of the Act's objectives." [May 11, 1973, P.L. 93-32, Sec. 1, 87 Stat. 65, 7 U.S.C. 930]

REA has sought to ensure feasibility and security, and to improve the financial strength of its borrowers, by taking a lien on each borrower's system and by closely regulating the construction and operation of the system. By the terms and conditions of its loans, REA retains approval rights over additions and extensions to the system, the manner of construction and maintenance of the system, key contracts relating to the construction and operation of the system, and the acquisition and disposition of property. In most cases, REA requires distribution borrowers to meet a TIER of not less than 1.5 and a DSC ratio of not less than 1.25. TIER and DSC requirements are set forth in the mortgage, loan contract or other contractual agreements with REA. These financial tests are designed to help develop equity, and hence financial strength, and to qualify the REA borrowers for private market financing.

In addition to directing the Administrator to establish loan terms and conditions, the RE Act explicitly provides in Section 7 that "No borrower of funds . . . shall, without the approval of the Administrator, sell or dispose of its property, rights, or franchises, acquired under the provisions of this Act, until any loan obtained from the Rural Electrification Administration, including all interest and charges, shall

have been repaid." In regulating the borrower's transactions pursuant to the terms and conditions of the loans or Section 7, the Administrator must consider the impact of the transaction on feasibility, security, the development of borrower's financial strength, as well as the objectives of the RE Act. In general, loss of high density and future high growth service territory can adversely affect all of these factors.

2. *Power Supply Borrowers*: Power supply borrowers are not-for-profit cooperatives providing wholesale electric service to their member/owners, the distribution cooperatives. Like the distribution borrowers, power supply borrowers have been structured to achieve RE Act purposes of providing affordable electric power to RE Act beneficiaries. REA provides financial assistance to power supply borrowers to construct facilities to meet the needs of RE Act beneficiaries, the consumers served by its distribution Members. REA evaluates requests for financial assistance to power supply borrowers in much the same manner as it does with distribution borrowers, considering the economics of the entire area served by the power supply borrower (i.e., the service territories of all distribution Members). REA will approve the financial assistance to power supply borrowers only if it determines that the proposed facilities constitute the most effective and economical means of meeting the power requirements of RE Act beneficiaries. See 7 C.F.R. 1710.254(a)(ii)(2).

The distribution borrowers are equity owners of a power supply borrower and are tied to their power supplier by a long-term all-requirements wholesale power contract required by REA.

The contract provides that the power supply borrower shall sell, and the member shall purchase, power at rates which are sufficient to meet the power supply borrower's costs, including repayment of REA loans and other debt coverage requirements. The wholesale power contracts provide that the Board of Directors of the power supply borrower shall establish rates so as to produce revenues sufficient, but only sufficient, the costs of operation and maintenance of all generation, transmission, and related facilities, the costs of power and energy purchased for sale by power supplier, to pay the cost of transmission services, and interest and principal on all indebtedness of the power supplier, and to provide for the establishment and maintenance of reasonable reserves. The wholesale power contracts obligate the Board of Directors, made up of representatives of each distribution Member, to review the rates at least annually and to revise them as necessary in order to produce the necessary revenues described above. The contracts provide that no revision in rates is effective unless approved in writing by the Administrator. These contracts ensure that all distribution borrowers and, ultimately, the rural consumers/owners, share the costs and benefits of the operations of the power supply borrower.

The wholesale power contracts are pledged to the REA as security for loans and form the basis for the Administrator's determinations of feasibility and security. Unlike investor-owned utilities, and largely as a by-product of the policy that rates be kept as low as possible through the not-for-profit structure, power supply borrowers have almost no equity to offer as security for

loans. As of December 31, 1990, the equity for all power supply borrowers nationwide represented only 8.05 percent of their total assets. (Informational Publication 201-1, p. xxix.) By comparison, investor-owned utilities, which combine the functions of distribution and power supply borrowers, have equity equalling 42.9 percent of their total assets. (Edison Electric Institute, Advance Release of Data for the 1991 Statistical Yearbook of the Electric Utility Industry, at p. 24.) In light of the objective of providing power at as low a cost as practicable, REA has generally, in the past, not required that such equity be developed and maintained by power supply borrowers. Rather, REA created a structure, implemented by the all-requirement wholesale power contract, that permitted REA to view the financial strength of the power supplier and all of its Members as an integrated whole. Any dilution of this whole has an adverse impact on not only the distribution systems, but on the wholesale power supplier also. REA has recently adopted a policy that requires power supply borrowers, as a condition for obtaining financial assistance through a loan or guarantee from REA, unless REA determines otherwise on a case by case basis, to develop a plan to increase equity towards meeting a minimum Equity Ratio (see definition) of 20 percent. See 7 C.F.R. 1710.116.

Thus, the success of the power supply structure, both in terms of providing low cost electric power and maintaining loan feasibility and security, depends on the financial strength of the distribution borrowers, and in particular on their ability to develop and maintain the loads necessary to generate sufficient revenues. Where the

power supply borrower has a surplus of generating capacity, loss of load clearly adversely affects the financial health of the entire integrated system, and the ability of that system to carry out the RE Act objectives. As a consequence, it is appropriate for REA, in exercising approval rights with respect to a distribution system, including in connection with the disposition of property or territorial service rights, to take into account the impact of the action not only on the distribution borrower, but also its power supplier and the other distribution borrowers that are part of the integrated power supply system.

The Administrator's findings of feasibility and security for a loan to a power supply borrower like Cajun must deal with the inherent difficulties of the electric generation industry in forecasting future needs. The planning horizon for adding new "base load" generation takes 8 to 10 years from identification of the need for new generation to the commercial availability of that generation. Systems like SLECA project their future needs, and although sophisticated econometric modeling is used to make these forecasts, such modeling cannot predict the impact of the loss of future loads through annexations and expropriations. Systems like SLECA and Cajun must plan and be ready to serve future loads at all times. During economically depressed times, the load growth and accompanying revenue do not materialize to amortize the debt incurred to build the generation that was originally projected to be required. As discussed above, this is why Cajun's debt had to be restructured.

When the loss of undeveloped electric service territory happens as a result of annexations, it

further compounds the problem both in the short term and more importantly in the long term.

When kWh sales do not materialize, the existing consumers must shoulder more of the fixed cost of the generation through increased rates. Because of the present non-competitive position of SLECA, such an eventuality leads to a further decline in usage thereby exacerbating the present non-competitive position of SLECA.

III. SLECA Impact Analysis:

Cajun and SLECA, individually, were asked by REA to prepare an analysis of the impact of the purportedly proposed expropriations on its system, and to provide such analyses to REA for its consideration.

A. *Phase II*: SLECA engaged GDS Associates, Inc., (GDS) of Marietta, Georgia, to develop a financial impact model to study the impact of losing the service territory, including the consumers and facilities that Morgan City would be expropriating under Phase II of its plan. GDS prepared a report *IMPACT OF MORGAN CITY PROPOSED EXPROPRIATION, AND FUTURE POTENTIAL EXPROPRIATIONS*, dated October 14, 1991. A copy of the report is attached as Attachment C. We have reviewed the study and have concluded that the methodology used to analyze the impacts is a valid means of measuring impacts. We have reviewed the underlying data, and it appears to be appropriate. Nothing has come to our attention to suggest that data is not valid and accurate.

GDS studied the impact of losing the expropriated area for the test year August 1989 through July 1990 ("Test Year"). The results of the study indicate that although the 252 lost consumers would represent 1.7 percent of SLECA's

total 14,828 consumers, 1.54 percent of total system kWh sales, and 1.65 percent of total system revenues, the expropriated area would result in loss of $63,106 (25.12 percent) of the system operating margins and $73,563 (13.31 percent) of total system margins. This is because the expropriation is of SLECA's highest density and high margin producing service area, "skimming the cream" from SLECA's system. In addition, the study of the Test Year indicates that the total system TIER, including the area to be expropriated, is 1.26; the total system TIER *not* including the area is 1.22. The TIER for the Test Year for the expropriated area is calculated by the GDS study to be 3.98.

The loss of the high margin-producing cooperative Members in the expropriated area would have an adverse financial effect on the system, and would place an additional financial burden on the remainder of the SLECA Members. The loss of margins produced by the lost consumers would have to be compensated for by the remaining SLECA consumers. SLECA would be required to raise its retail rates to meet the requirements of the mortgage to maintain minimum TIER of 1.5 required by REA.

GDS also prepared a supplemental study dated May 11, 1992, to the original study, attached as Attachment D, which combines financial data from the original GDS study with findings from a study prepared for Cajun by Southern Engineering Company of Atlanta, Georgia (Southern Engineering). The supplemental study also includes other costs and damages to SLECA. The supplemental study provides information concerning projected financial impacts on both SLECA and Cajun. The supplemental study

indicates the total accumulated loss to SLECA based upon the Test Year data due to Phase II expropriation would be as follows:

1991	1992	1997	2000	2010	2020
$653,605	$722,482	$1,020,684	$1,167,650	$1,527,627	$1,748,623

The above total accumulated 1991 figure of $653,605 was derived from the lost margins of $72,321 plus Severance Damages of $289,925 plus Consequential Damages of $14,097 plus the Expropriated Facilities of $277,262. A general discussion of how the above figures were obtained follows in paragraphs 1 through 4 below. A copy of the assumptions and associated calculations are attached as Attachment E titled *VALUATION OF DAMAGES FROM PROPOSED EXPROPRIATION OF CONSUMERS AND FACILITIES IN MORGAN CITY* dated March 20, 1991.

1. *Lost Margins*: The lost margins for the Test Year were obtained from revenue less costs associated with service plus non-operating margins. The revenue was computed from actual sales to the Phase II consumers during the Test Year. The expenses were allocated by various methods including ratios of plant serving the Phase II consumers to Total Utility Plant, Phase II consumers to total consumers and actual power usage by the Phase II consumers. (See Schedule 6 in Attachment E).

2. *Severance Damages*: The severance damages were computed using the original investment in the facilities associated with the Phase II area times an annual carrying charge, which was based on a sum of the carrying costs as a percent of Total Utility Plant for the Test Year. The annual carrying charge was then multiplied by the number of years remaining before capital improvement on the subject facilities was neces-

sary. This total was then discounted at a discount rate, computed using a ratio of total net margins plus interest divided by net rate base (5.66 percent), to arrive at a discounted present value of facilities in the Phase II expropriation. (See schedule 9 in Attachment E).

3. *Consequential Damages*: Consequential Damages consist of the cost associated with the reintegration of SLECA's system after the expropriation. Reintegration is the actual disconnection of the portion of the system which has been expropriated and the rehabilitation of the remainder of system after disconnection to keep the system operating properly. The costs associated with this may include, for example, disconnection and rerouting of lines, construction of new tie lines, substation modifications and labor costs.

4. *Expropriated Facilities*: The value of the Expropriated Facilities was determined by the depreciated book value of the physical facilities associated with Phase II as of July 31, 1990. This was determined by an inventory of the facilities in Phase II by Brooks-Harbour and Associates, Inc. Brooks-Harbour and Associates, Inc., of Baton Rouge, Louisiana, is a consulting firm which was hired to inventory the facilities and determine replacement cost new less depreciation as of July 31. 1990.

To arrive at the Total Accumulated loss for the future years in the Supplemental Study, the Lost Margins were discounted at a rate of 5 percent, which was stated to be a preliminary discount rate and subject to change based upon assumptions utilized in final valuation, for a period of 45 years to obtain the net present value of the lost margins. This was then added to the Total

Accumulated loss of the previous year. It should be noted that the accumulated loss figures consider just the present value of the margins lost in the Test Year. There is no consideration for loss of potential load growth in the area. While we believe that the loss of potential load growth must not be ignored by REA in evaluating impacts, we do not believe it is necessary in this case to attempt to project such losses. Also, the 45 year forecast period used in the Supplemental Study was determined by the years remaining in a franchise agreement SLECA has in the parish of St. Mary. The same methodology was used in calculating total accumulated lost revenues for Phase III and Houma City.

B. *Phase III*: If Morgan City were successful in acquiring the Phase II consumers, the cooperative's distribution lines serving the remainder of the Morgan City area in the Test Year would then serve 267 consumer/members. Exhibit 1 attached to the original GDS study is a map which indicates that Morgan City has a 3-phase plan of expropriation. The GDS study assumes that there is a strong possibility that Morgan City would also attempt to expropriate these SLECA Members. (Phase III). The study states that the assumption is based on statements by an expert witness for Morgan City (Mr. Beard), and that he testified in a deposition that Morgan City would likely attempt to expropriate these consumers. The study prepared by GDS indicates for the Test Year that if Morgan City were successful in expropriating the Phase III territory and consumers on SLECA's Morgan City distribution lines, the total system TIER including the Phase III expropriated area would be 1.26; TIER would be 1.21 not including the area. The TIER for the expropriated area serving the approximately 267 consumers is 5.26.

The supplemental study indicates the total accumulated loss to SLECA based upon the Test Year data due to Phase III expropriation would be as follows:

1991	1992	1997	2000	2010	2020
$662,977	$764,345	$1,203,213	$1,419,505	$1,949,290	$2,274,532

C. *Houma Expropriation*: SLECA is also concerned that the Morgan City taking is not isolated, that Morgan City and other municipalities may in the future attempt to take the more lucrative electric service areas and rights and consumer/members served by SLECA and other REA borrowers. The GDS study analyzes the strong possibility that Houma will expand its City limits and also attempt to expropriate SLECA Members within its City limits. The study states that the assumption is based on public statements by City officials, including the Mayor, that Houma would like to acquire these SLECA consumers. Thus, the study also estimates the impact of loss of service area and consumers to the City of Houma municipal electric system.

GDS studied the impact of potential expropriation of the Houma area containing 602 consumers during the Test Year. The results of the study indicate that although the lost consumers would represent 4.06 percent of the total number of consumers, 3.81 percent of total system KWh sales, and 3.67 percent of total system revenues, the expropriated area would result in the loss of 25.86 percent of system operating margins and 14.44 percent of total margins. As with Morgan City's proposed expropriation, this is because Houma plans to take the most efficient and profitable service areas. In addition, the study indicates that the total system TIER including the expropriated area is 1.26, and 1.22 not including the area. The TIER for the expropriated area is 2.41.

The supplemental study indicates the total accumulated loss to SLECA based upon the Test Year data due to a Houma city expropriation area would be as follows:

1991	1992	1997	2000	2010	2020
$1,987,221	$2,060,515	$2,377,841	$2,534,232	$2,917,295	$3,152,463

D. *Consolidated Impacts on SLECA*: The cumulative results of the GDS study of the consolidated Morgan City and Houma service areas, including the areas being expropriated now and the areas for which future expropriation may be planned, for the Test Year indicate that although the 1,121 lost consumers would represent 7.56 percent of SLECA's total 14,828 consumers, 7.05 percent of total system kWh sales, and 7.20 percent of total system revenues, the expropriated areas would result in loss of $221,744 (88.26 percent) of the system operating margins and $260,946 (47.21 percent) of total system margins.

The density of consumers in the expropriated areas is very high relative to the remainder of the system. Because of the relatively low level of plant investment required to serve these consumers, the related fixed costs are also low, which accounts for the high level of margins by the 1,121 consumers. The study indicates that these consumers produce a TIER of 3.46 compared to the system total of 1.26 and that their loss in the Test Year reduces the system TIER from 1.26 to 1.13. Without these consumers, SLECA would have to increase rates to the remainder of the consumers to make up the shortfall in margins to attempt to maintain financial integrity and TIER requirements imposed by REA and other SLECA lenders.

The mortgage establishes a minimum TIER of 1.50. REA encourages its borrowers to establish targeted TIER goals greater than 1.5 so that, given certain unforeseen increases in expenses, a borrower's system

will not encounter problems with its lenders under the mortgage.

The mortgage requires that borrowers maintain a DSC level above 1.25. Any borrower operating at a DSC of less than 1.25 faces problems pursuant to the provisions of the REA mortgage, and must, at a minimum take corrective action.

In addition to the loss of margins, the GDS study reflects the effects of the related reduction in revenues, and the increase in Cajun's wholesale power costs due to the loss of the 1,121 consumers. The study concludes that there might not be a material reduction in operating costs should those consumers be lost from the system. GDS reached this conclusion based upon the assumption that the incremental cost of servicing the highly populated expropriated areas is not nearly as high as that of the remainder of the system. In that case, the remaining consumers would have to pay higher rates to make up for the shortfall in revenues to pay the costs of operation and maintenance. The GDS study indicates that the continuing loss of consumers from successive expropriations would increase the revenue requirements from the other consumers, also leading to increasing rate levels. GDS reached this conclusion based upon a finding that a large portion of SLECA's operating costs (excluding wholesale power costs) are fixed and do not vary with the number of consumers served or KWh sold and that the consumers remaining on the SLECA system would have to pay a higher portion of the fixed costs.

E. *Other Impacts*: The GDS study states that in addition to the adverse impact to the financial integrity of the SLECA system as indicated for the Test Year, the expropriations would have the following additional adverse effects on SLECA:

1. *Loss of revenue growth in future years from the existing consumers.* Due to its Test Year and capitalization methodology for calculating damages, it assumes no load growth. If those consumers experience load growth, the impact will be significantly greater. Since the expropriation would occur in densely populated residential portions of SLECA's territory, it is most likely that load growth in those territories will be higher than in the remainder of the system. SLECA has been impaired by the economic downturn. When an improved local economy occurs, it is likely that the densely-populated portions of SLECA's system would produce higher usage kilowatt-hour sales levels, thus producing additional margins for the SLECA system.

2. *Uncertainty of planning for SLECA's service area, which would lead to uncertainty in the quality and reliability of service.* Planning for an electric service area can be frustrating in the absence of certainty as to the area to be served. Unless SLECA is certain of its service area, it would be unable to project the total number of consumers, the anticipated load demand on its system, and the kilowatt-hour sales. Furthermore, this uncertainty would lead to higher risks of loss when system improvements must be added to the distribution system. This uncertainty also impacts Cajun's ability to plan for future load growth.

3. *SLECA's wholesale power cost could be expected to increase.* SLECA's wholesale power costs from Cajun could be expected to increase as a direct result of the loss of consumers. This is because Cajun has excess generating capacity,

and has been unable to market the excess at prices equal to the wholesale rates charged to SLECA. Thus, the loss of consumers would result directly in reduced demand and energy, and reduce recovery by Cajun of its operating costs. This would result in Cajun increasing rates charged to SLECA and the other Cajun Members.

IV. Cajun Impact Analysis:

A. *Analysis of Expropriation Impacts:*

SLECA, with annual sales of 365,000 MWh, represents approximately 7 percent of Cajun's total Member sales of approximately 5.34 GWh, and produces approximately 4.4 percent of Cajun's Member revenues.

1. *Cajun Analysis of Expropriations:*

Cajun engaged Southern Engineering Company of Atlanta, Georgia (Southern Engineering) to develop a financial impact model to study the impact of losing the service territory, facilities and right to serve the consumers that Morgan City would be expropriating under Phases II of its plan. Southern Engineering prepared a report, *REPORT ON THE IMPACT OF THE EXPROPRIATION OF THE CITY OF MORGAN CITY, LOUISIANA AND THE HOUMA AREA ON CAJUN ELECTRIC POWER COOPERATIVE, INC.*, dated November 1991. A copy of the report is attached as Attachment F. We have reviewed the study and have concluded that the methodology used to analyze the impacts represent a valid and reasonable methodology for measuring the impacts.

Southern Engineering's study concluded that through the term of the study (end of year

2020) the net present value of Phase II lost revenues would exceed $2.6 million and total nonfuel revenue (i.e., revenue collected for Cajun's wholesale costs less the fuel cost component of operation of generation facilities) lost would be over $8 million. This amount was obtained by forecasting the lost amount of revenue to Cajun derived from the Phase II area by forecasting rates while leaving the amount of demand and energy required by SLECA to serve this area at its 1991 level. Any load growth that would be experienced would cause this value to be significantly higher. REA has reviewed the numbers that were used in this forecast and conclude that the numbers, except for the lack of load growth, are reasonable. REA believes that load growth for the expropriated consumers will occur, thus the impact is understated.

If Morgan City were successful in acquiring the Phase II consumers, it is likely the City would begin proceedings to take the area identified as Phase III of the expropriation plans. The loss experienced as a result of the subsequent taking was also analyzed by Southern Engineering. They found that the net present value of Phase III lost revenue totaled nearly $2.65 million and total lost nonfuel revenue would exceed $8 million through 2020. Like the Phase II analysis, the Phase III analysis did not attempt to quantify the effect of possible load growth. Therefore, other than the load growth assumption, REA finds that the resultant amounts are reasonable.

Southern Engineering also attempted to quantify the effect on Cajun's revenue of a taking of an area around the City of Houma that contains

602 of SLECA's consumers. The resulting loss experienced by Cajun as a result of this taking amounted to $7.5 million on a net present value basis and a total of over $23 million in lost nonfuel revenues through 2020. As with previous analysis, Southern Engineering did not model load growth, so we again disagree with only that premise of their study and find the rest to be reasonable.

In aggregate, the cumulative results of the Southern Engineering study of the consolidated Morgan City and Houma service areas, including the areas being expropriated now and the areas for which future expropriation is planned, indicate that Cajun would experience a loss of over $39 million in nonfuel revenue, which gives a net present value loss of nearly $12.7 million.

2. *REA Analysis of Expropriation:*

REA's preliminary analysis of the financial impact of the expropriations, Attachment B, made provisions for load growth, unlike the Southern Engineering study, and further viewed the situation as Cajun's lost contribution to fixed costs. This analysis spanned the entire term of the existing wholesale power agreement which is in effect until the year 2026 and allowed for different load growth scenarios to be analyzed. REA determined that the net present value loss for Phase II, Phase III and Houma expropriations are $2.3 million, $2.3 million and $4.6 million, respectively. These losses total a net present value of $9.2 million for all expected expropriation attempts with Cajun experiencing 3 percent load growth. REA further as-

sumed that Cajun will attempt to secure off-system sales in the spot market since their generation mix does not lend itself to reduced production easily and they have been unable to secure long term firm power sales off-system. Taking into account the somewhat different methodology and assumptions used by Southern Engineering and REA, Southern Engineering's analysis of the effects of the expropriations supports REA's initial conclusion that Cajun will experience significant revenue loss as a result of these expropriations.

Morgan City made no attempt to compensate Cajun for this potential loss. As discussed below, REA will experience a direct loss on the amount of uncollected revenue because of these actions.

B. *Overall Impact on Cajun*:

The loss of consumers because of Morgan City's Phase II expropriation of SLECA's consumers will result in lost revenue to Cajun. The prospect of additional losses caused by the Morgan City Phase III and Houma expropriation greatly increases the adverse impact on Cajun.

Morgan City's proposed expropriation exacerbates the problems of low load growth and excess capacity existing in Louisiana's rural electric system. The rural cooperative system in Louisiana, through Cajun, has undertaken federally assisted debt to enable it to generate over 10,000 GWh a year. This capacity was deemed necessary to meet an annual load growth projected to be around 9 percent. As stated above, the projected load growth did not materialize and the rural cooperative system is now burdened with 5,000 (GWh) of excess capacity. Morgan City is now proposing to further damage the Louisiana rural electric

system by cream skimming SLECA's most profitable consumers. As noted throughout this analysis, this further reduction of load in a system which suffers from inadequate energy sales can only result in lost revenues.

Lost revenue to Cajun directly affects Cajun's payment obligation under "Note B." As described above "Note B" represents a contingent payment obligation until final maturity in 2036 when all amounts become due. Until maturity, payments must be made on "Note B" only if certain revenue generating events occur. Increased revenues from Member sales would obligate Cajun to make payments on "Note B." If payments are not made on "Note B," Cajun is obligated to pay all outstanding amounts at maturity. The outstanding balance of "Note B" is in excess of $1 billion. The likelihood of receiving such a lump sum payment is remote. Therefore, every effort must be made to preserve Cajun's consumer base and to encourage load growth.

In addition to the detrimental effect on the payment of federal debt, the effect of the Phase II expropriation frustrates the objectives of the REA program in Louisiana by increasing the likelihood of rate increases. As stated above, great effort has been put into lowering the rural electric rates in Louisiana so that they are supportable by the local economy and more competitive with local utilities. REA has agreed to a major reduction in Cajun's current debt service payments to effectuate a wholesale rate reduction in an attempt to improve the viability the of Louisiana rural electric cooperative system. The Morgan City Phase II expropriation at a minimum, undermines that effort. Cumulative takings represented by the Phase III and Houma expropriations, by significantly reducing Cajun's revenues, would cause Cajun to raise Member rates to compensate for such loss, in

effect negating federal efforts to lower rural electric rates in Louisiana.

V. *Summary*: Based on the foregoing analysis we have concluded as follows:

The Phase II property which is the subject of Morgan City expropriation, as well as that property which is the subject of potential Phase III and City of Houma annexation, was financed with REA loans bearing a subsidized interest rate. The customers in these areas were initially brought electric service through the REA Program and are RE Act beneficiaries. The disposition of SLECA's property and service rights in these areas requires approval of the Administrator under Section 7 of the RE Act.

The proposed expropriation must be evaluated in the light of the interests of REA and the federal taxpayer in carrying out the RE Act objecive of providing reliable electric service in rural area at rates as low as practicable, in maintaining and improving the financial stability of borrowers, in protecting the feasibility of and security for outstanding loans and in assuring that outstanding REA loans will be repaid. In evaluating these interests, we have considered the impact on the rates and financial stability of SLECA, Cajun, and Cajun's Members as well as on the repayment of REA debt and, hence, the federal taxpayer. Also, we have evaluated the impacts of the Phase II expropriation by itself and as a part of the potential Phase III and City of Houma takings. We have concluded as follows:

1. SLECA provides electric service on an area coverage basis to RE Act beneficiaries located in a relatively low income area. The electric rates which the Act beneficiaries served by SLECA must pay are significantly higher than those charged by competitors of SLECA. To carry out the Act objective of providing reasonably priced power to persons served by SLECA,

REA should take all reasonable actions to avoid rate increases.

2. SLECA's financial profile is not strong. While it has met required financial tests established by REA and CFC, it has barely exceeded the minimal levels and is significantly below national averages. Overall Cajun and the 13 distribution members comprising Cajun, are not financially healthy. Cajun has significant surplus power and, even after debt restructuring, Cajun's rates are significantly higher than its competitors. Any further deterioration in the financial condition of SLECA, Cajun and the other distribution members will frustrate the RE Act objective of developing and maintaining the financial strength of the REA borrowers.

3. Any loss of high density/high growth or high margin producing service territory will have a long term adverse impact on SLECA. SLECA may not be able to meet minimum TIER levels without increasing its rates. While qualification is difficult, it is clear that loss of high density/high growth and high margin producing areas will adversely effect SLECA's rates and financial health.

4. Any loss of load by SLECA or other Cajun members will adversely effect Cajun and all of its members since the integrated power supply system must carry the same fixed costs with smaller KWh sales. Further, any load loss will, in all likelihood, reduce the amount of REA loans which will be repaid pursuant to the terms of the Debt Restructure Agreement. While the amount of the direct loss that REA will suffer is difficult to project, it is clear that there will be a reduction in the amount of payment received by REA on the B Note as a result of load loss

by Cajun and that the interests of REA and the federal taxpayer in maximizing recovery on outstanding loans will be frustrated.

5. For REA's purposes, the Morgan City expropriation action should not be considered an isolated taking. Rather, if successful, it could mark the beginning of several actions by Morgan City and other municipalities to acquire property and territorial service right of SLECA and other REA borrowers in Louisiana. The property and territorial service rights sought by Morgan City in Phase II and, potentially, Phase III and by the City of Houma are high density/high growth and high margin areas. The property and territorial service rights were acquired by SLECA with REA approval and financial assistance under the RE Act and represent the more lucrative portions of the SLECA system. Loss of such property and service rights would adversely affect remaining RE Act beneficiaries served by the system. The loss of any of this property and service rights would frustrate the objectives of the Act to provide electric service at reasonable rates, to develop the financial strength of REA borrowers, to maintain the feasibility of and security for outstanding loans and to ensure that REA loans are repaid.

VI. *Conclusion*:

For the reasons summarized above, we believe that the disposition of the SLECA property including territorial service rights which is the subject of the Phase II and Phase III proposal of Morgan City and the proposal of the City of Houma is contrary to the interests of REA and would frustrate the objectives of the RE Act. Therefore, we recommend that, under section 7 of the RE Act, you withhold approval of the disposition pursuant to expropriation action.

RECOMMENDED:

/s/ [Illegible]
Director, Southern Regional Division — 6/12/92 Date

/s/ John H. Arnesen
Assistant Administrator—Electric — 6/12/92 Date

CONCURRED:

/s/ Thomas L. Eddy
Acting Assistant to the Administrator, Financial Services Staff — 6/12/92 Date

/s/ Michael W. Kelly
The Office of the General Counsel — 6/12/92 Date

APPROVED:

/s/ [Illegible]
Acting Administrator — 6/16/92 Date

Attachments

APPENDIX E

§ 901. Short title

This chapter may be cited as the "Rural Electrification Act of 1936".

§ 902. Loans by Secretary; investigations and reports

(a) The Secretary of Agriculture is authorized and empowered to make loans in the several States and Territories of the United States for rural electrification and the furnishing of electric energy to persons in rural areas who are not receiving central station service and for the purpose of furnishing and improving electric and telephone service in rural areas, as provided in this chapter, and for the purpose of assisting electric borrowers to implement demand side management, energy conservation programs, and on-grid and off-grid renewable energy systems; to make, or cause to be made, studies, investigations, and reports concerning the condition and progress of the electrification of and the furnishing of adequate telephone service in rural areas in the several States and Territories; and to publish and disseminate information with respect thereto.

* * * *

§ 907. Acquisition of property pledged for loans; disposition; sale of pledged property by borrower

The Secretary is authorized and empowered to bid for and purchase at any foreclosure or other sale, or otherwise to acquire, property pledged or mortgaged to secure any loan made pursuant to this chapter; to pay the purchase price and any costs and expenses incurred in connection therewith from the sums authorized in section 903 of this title; to accept title to any property so purchased or acquired in the name of the United States of America; to operate or lease such property for such period as may be deemed necessary or advisable to pro-

tect the investment therein, but not to exceed five years after the acquisition thereof; and to sell such property so purchased or acquired, upon such terms and for such consideration as the Secretary shall determine to be reasonable.

No borrower of funds under sections 904 or 922 of this title shall, without the approval of the Secretary, sell or dispose of its property, rights, or franchises, acquired under the provisions of this chapter, until any loan obtained from the Rural Electrification Administration, including all interest and charges, shall have been repaid.

§ 908. Transfer of functions of Administration created by Executive Order

The administration of loans and contracts entered into by the Rural Electrification Administration established by Executive Order Numbered 7037, dated May 11, 1935, may be vested by the President in the Secretary; and in such event the provisions of this chapter shall apply to said loans and contracts to the extent that said provisions are not inconsistent therewith. The President may transfer to the Secretary the jurisdiction and control of the records, property (including office equipment), and personnel used or employed in the exercise and performance of the functions of the Rural Electrification Administration established by such Executive order.

§ 912. Extension of time for repayment of loans

(a) The Secretary is authorized and empowered to extend the time of payment of interest or principal of any loans made by the Secretary pursuant to this chapter: *Provided, however,* That with respect to any loan made under section 904 or 922 of this title, the payment of interest or principal shall not be extended more than five years after such payment shall have become due, and with respect to any loan made under section 905 of this title, the payment of principal or interest shall not be extended

more than two years after such payment shall have become due: *And provided further,* That the provisions of this section shall not apply to any obligations or the security therefor which may be held by Reconstruction Finance Corporation under the provisions of section 903 of this title.

(b)(1) Subject to limitations established in appropriations Acts, the Secretary shall permit any borrower to defer the payment of principal and interest on any insured or direct loan made under this Act under circumstances described in this subsection, notwithstanding any limitation contained in subsection (a), except that such deferment shall not be permitted based on the determination of the Secretary of the financial hardship of the borrower.

(2)(A) In the case of deferments made to enable the borrower to provide financing to local businesses, the deferment shall be repaid in equal installments, without the accrual of interest, over the 60-month period beginning on the date of the deferment, and the total amount of such payments shall be equal to the amount of the payment deferred.

(B) In the case of deferments made to enable the borrower to provide community development assistance, technical assistance to businesses, and for other community, business, or economic development projects not included under subparagraph (A), the deferment shall be repaid in equal installments, without the accrual of interest, over the 120-month period beginning on the date of the deferment, and the total amount of such payments shall be equal to the amount of the payment deferred.

(3)(A) A borrower may defer its debt service payments only in an amount equal to an investment made by such borrower as described in paragraph (2).

(B) The amount of the deferment shall not exceed 50 percent of the total cost of a community or economic de-

velopment project for which a deferment is provided under this subsection.

(C) The total amount of deferments under this subsection during each of the fiscal years 1990 through 1993 shall not exceed 3 percent of the total payments due during such fiscal year from all borrowers on direct and insured loans made under this Act and shall not exceed 5 percent of such total payments due in each subsequent fiscal year.

(D) At the time of a deferment, the borrower shall make a payment to a cushion of credit account established and maintained pursuant to section 940c of this title in an amount equal to the amount of the payment deferred. The balance of such account shall not be reduced by the borrower below the level of the unpaid balance of the payment deferred. Subject to limitations established in annual appropriations Acts, such cushion of credit amounts and any other cushion of credit and advance payments of any borrower shall be included in the interest differential calculation under section 940c(b)(2)(A) of this title.

(4) The Secretary shall undertake all reasonable efforts to permit the full amount of deferments authorized by this subsection during each fiscal year.

§ 912a. Rescheduling and refinancing of loans

In addition to the loan extension authority provided in section 12 of the Rural Electrification Act [7 U.S.C.A. § 912], the Secretary of Agriculture is authorized to adjust and readjust the schedules for payment of principal and interest on loans to borrowers under programs administered by the Secretary under the Rural Electrification Act of 1936 (7 U.S.C. 901 et seq.), and to extend the maturity date of any such loan to a date not beyond forty years from the date of such loan where he determines such action is necessary because of the impairment of the economic feasibility of the system, or the loss, destruction,

or damage of the property of such borrowers as a result of a major disaster.

§ 913. Definitions

As used in this chapter the term "rural area", except as provided in section 924(b) of this title, shall be deemed to mean any area of the United States not included within the boundaries of any urban area, as defined by the Bureau of the Census, and such term shall be deemed to include both the farm and nonfarm population thereof; the term "farm" shall be deemed to mean a farm as defined in the publications of the Bureau of the Census; the term "person" shall be deemed to mean any natural person, firm, corporation, or association; the term "Territory" shall be deemed to include any insular possession of the United States; and the term "Secretary" shall be deemed to mean the Secretary of Agriculture.

§ 915. Purchase of financial and credit reports

The Secretary of Agriculture is authorized to purchase such financial and credit reports as may be necessary to carry out the Secretary's authorized work; *Provided,* That purchases under this authority shall not be made unless provision is made therefor in the applicable appropriation and the cost thereof is not in excess of limitations prescribed therein.

§ 916. Criteria for loans

In order to insure coordination of electric generation and transmission financing under this chapter with the national energy policy, the Secretary in making or guaranteeing loans for the construction, operation, or enlargement of generating plants or electric transmission lines or systems, shall consider such general criteria consistent with the provisions of this chapter as may be published by the Secretary of Energy.

§ 930. Congressional declaration of policy

It is hereby declared to be the policy of the Congress that adequate funds should be made available to rural electric and telephone systems through direct, insured and guaranteed loans at interest rates which will allow them to achieve the objectives of this chapter, and that such rural electric and telephone systems should be encouraged and assisted to develop their resources and ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organizations and other sources at reasonable rates and terms consistent with the loan applicant's ability to pay and achievement of this chapter's objectives.

APPENDIX F

United States Constitution, Article VI, Clause 2 ("Supremacy Clause")

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.